SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 212

WILLIAM R. THORSEN, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCTOBER 26, 1933

[1*] DOCKET No. 38,095.

WILLIAM R. THORSEN

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: EDWIN H. CASSELS, Esq.
ANDREW L. CAMPBELL, C.P.A.

For Commissioner: W. F. GIBBS, Esq.
HAROLD ALLEN, Esq.
WILLIS R. LANSFORD, Esq.
H. D. THOMAS, Esq.

DOCKET ENTRIES.

1928.

May 2—Petition received and filed. Taxpayer notified. (Fee paid.)

May 3—Copy of petition served on General Counsel.

July 2—Answer filed by G. C.

July 14—Copy of answer served on taxpayer. General calendar.

1930.

Aug. 18—Hearing set Oct. 15, 1930.

Oct. 13—Motion to consolidate with 34,131 for hearing at later date filed by taxpayer.

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*Page-number appearing at the top of page of original certified Transcript of Record.

1930.

Oct. 15—Hearing had before John E. Murdock, Div. 3, on merits and motion to Dkt. 34,131. Continued to Oct. 30, 1930. No action taken on motion for consolidation.

Oct. 15—Order placing proceeding on day calendar of Oct. 30, 1930, for hearing on the merits entered.

Oct. 30—Hearing had before Herbert F. Seawell, Div. 4 on merits. Submitted stipulation of facts filed. Briefs due in 60 days.

Nov. 12—Transcript of hearing of Oct. 30, 1930, filed.

Dec. 27—Brief filed by taxpayer.

Dec. 29—Brief filed by G. C.

1931.

June 12—Findings of fact and opinion rendered Herbert F. Seawell, Div. 4. Judgment will be entered under Rule 50.

June 29—Order that pursuant to Section 601 (b) of the Revenue Act of 1928, the division report of June 2, 1931, promulgated June 12, 1931, be reviewed by the Board, entered.

Aug. 6—Stipulation to file supplemental brief filed.

Aug. 7—Order granting petitioner and Commissioner 30 days to file supplemental briefs entered.

Aug. 8—Supplemental memo. brief filed by taxpayer.

Sept. 3—Supplemental brief filed by G. C.

1931.

Oct. 27—Findings of fact and opinion rendered, Mr. Seawell, Div. 4. Judgment will be entered under rule 50.

Nov. 23—Notice of settlement filed by G. C.

Dec. 1—Hearing set Dec. 16, 1931.

Dec. 16—Consent to settlement filed by taxpayer.

Dec. 16—Hearing had before Mr. Smith on settlement under Rule 50. Referred to Mr. Seawell for decision.

Dec. 19—Decision entered, Herbert F. Seawell, Div. 4.

[2] Docket No. 38,095.

1932.

Apr. 16—Petition for review by U. S. Cir. Ct. of Ap. (9) with assignments of error filed by taxpayer.

Apr. 16—Praecipe filed.

Apr. 16—Certificate of service of petition and praecipe filed.

Apr. 23—Proof of service of petition and praecipe filed.

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[3] Filed May 2, 1928.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:CR:G-4:60-D:GC) dated March 6, 1928, and as a basis of his petition alleges as follows:

(1) Petitioner is an individual, residing at 2307 Piedmont Avenue Berkeley, California, and having his principal office at #1107 Crocker-First National Bank Building, San Francisco, California.

(2) On or about March 6, 1928, the Commissioner of Internal Revenue at Washington, D. C., mailed to the petitioner at the above address in San Francisco, California, a letter and notice of deficiency claiming a deficiency in tax in the amount of $36,720.96 for the taxable year 1923. A copy of said notice of deficiency is hereto appended marked Exhibit "A."

[4] (3) The taxes in controversy are income taxes for the year 1923 in the amount of $36,720.96.

(4) The determination of tax set forth in said notice of deficiency is based upon the following errors:

I.

The Commissioner of Internal Revenue erred in his determination that the taxable dividends received by the petitioner from the West Side Lumber Company during the calendar year 1923 amounted to $278,505.90.

II.

The Commissioner of Internal Revenue erred in finding that the taxable dividends reported by the petitioner in his 1923 tax return as having been received from the West Side Lumber Company during 1923 amounted to $181,812.

[5] III.

The Commissioner of Internal Revenue erred in increasing the taxable income of the petitioner for the year 1923 by adding thereto the sum of $96,693.90, which amount was arrived at by the Commissioner as follows:

"Taxable dividends from the West Side Lumber Company—

Corrected	$278,505.90
Reported on Return	181,812.00
Addition	$96,693.90

Of the total dividends received by you during this year 25.05% have been allocated as taxable. Since you received $1,111,800 the amount taxable on your return is $278,505.90."

IV.

The Commissioner of Internal Revenue erred in holding that 25.05% of the total dividends received by the petitioner during the year 1923 from the West Side Lumber Company were taxable dividends under the provisions of Section 201 of the Revenue Act of 1921, said allocation having been determined by the Commissioner as follows:

Dividend	February 12, 1923	$ 10 per share	100.00%	taxable	$10.00
"	April 14, "	340 "	22.85	"	77.69
	Total	$350 per share	25.05%	"	$87.69

[6] V.

The Commissioner of Internal Revenue erred in finding that the total dividends received by the petitioner from the West Side Lumber Company during the year 1923 amounted to $1,111,800, whereas the taxpayer did receive and report the receipt of dividends from that source as follows:

	Total Dividends Received.	Taxable Dividends Reported.
Dividends from the West Side Lumber Company:		
February 12, 1923—3,270 shares @ $ 10	$ 32,700.00	32,700.00
April 14, " —3,270 " @ 340	1,111,800.00	181,812.00
	$1,144,500.00	214,512.00

VI.

The Commissioner of Internal Revenue erred in finding that 22.85% of the dividend paid by the West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that Company subsequent to March 1, 1913, and that 22.85% of that dividend was therefore taxable to the recipients.

VII.

The Commissioner of Internal Revenue erred in finding that only 77.15% of the dividend paid by the West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913, and that only 77.15% of that dividend was therefore nontaxable.

[7] VIII.

The Commissioner of Internal Revenue erred in determining that the surplus of the West Side Lumber Company accumulated subsequent to March 1, 1913, and available for dividends on April 14, 1923, amounted to $1,165,282.92, or 22.85% of the dividend of $5,100,000 then paid, which amount was arrived at by the Commissioner as follows:

Surplus of West Side Lumber Company.

Surplus, March 1, 1913.....			$4,332,684.78
Subsequent Earnings—			
Year ending February 28,	1914.....		$ 4,594.62
" " "	1915	(Loss $193,139.67)	
" " "	1916	(Loss $211,707.32)	
" " "	1917		60,495.56
" " "	1918		57,901.55
" " "	1919		208,737.34
" " "	1920		543,490.33
" " "	1921		640,837.43
" " "	1922		182,954.63
" " "	1923		718,858.29
" " "	1924	up to April 14, 1923	
44/366th of $311,209.54			37,413.17
			$2,455,282.92

Less:			
Dividends Paid—			
Year ending Feb. 28, 1918	15,000 shs. @ $6....	$ 90,000.00	
" " " 1920	15,000 " @ 5....	75,000.00	
" " " 1921	15,000 " @ 25....	375,000.00	
" " " 1922	15,000 " @ 20....	300,000.00	
Sept. 15, 1922	15,000 " @ 10....	150,000.00	
Dec. 18 "	15,000 " @ 10....	150,000.00	
Feb. 12, 1928	15,000 " @ 10....	150,000.00	
			1,290,000.00
Surplus available for dividends as at April 14, 1923 (Taxable)		22.85%	1,165,282.92
Amount distributed out of Surplus accumulated prior to March 1, 1913 (Non-Taxable)		77.15	3,934.717.08
Total dividend declared and paid on April 14, 1923— 15,000 shares at $340		100.00%	$5,100,000.00

[8] IX.

The Commissioner of Internal Revenue erred in determining that the taxable portion of the dividend paid by the West Side Lumber Company on April 14, 1923, amounted to $1,165,282.92 or 22.85% of the dividend then paid (Item VIII, *supra*) by specifically omitting from his calculation of surplus accumulated by that company subsequent to March 1, 1913, all of the earnings received, expenses paid, and depreciation sustained by the corporation during the two fiscal years ending February 28, 1915, and February 29, 1916, in the following amounts:

	Year ending Feb. 28, 1915	Year ending Feb. 29, 1916
Sales and Other Income	$675,738.85	646,732.42
Less:		
Cost and Expenses	$720,725.62	717,617.75
Depreciation and Depletion	148,152.90	140,821.99
	$868,878.52	858,439.74
Net Loss, carried to Surplus	$193,139.67	211,707.32

[9] X.

The Commissioner of Internal Revenue erred in determining that the nontaxable portion of the dividend paid by the West Side Lumber Company on April 14, 1923, amounted to $3,934,717.08 or 77.15% of the total dividend then paid (Item VIII, *supra*) by specifically deducting from the surplus accumulated by the company prior to March 1, 1913, the losses and depreciation sustained by the company during the two fiscal years ending February 28, 1915, and February 29, 1916, amounting to $193,139.67 and $211,707.32, respectively (Item IX, *supra*), thereby denying to the corporation and its stockholders the statutory right to recover, either through depreciation allowances or by nontaxable distribution, all of the surplus of the corporation which existed on March 1, 1913, and which amounted to $4,[illegible]684.78.

XI.

The Commissioner of Internal Revenue erred in holding that $1,165,276.92 of the earnings of the West Side Lumber Company subsequent to March 1, 1913, were available for dividends on April 14, 1923, when, as a matter of fact, at least $404,846.99 of the undistributed earnings subsequent to February 29, 1916, has been used to make good the losses and depreciation sustained by the company during the two fiscal years ending February 28, 1915, and February 29, 1916 (Item IX, *supra*).

[10] XII.

The commissioner of Internal Revenue erred in not finding from his computation of the Surplus Ac-

count of the West Side Lumber Company (Item VIII, *supra*):

(a) That the total Surplus of the Company on April 14, 1923 amounted to $5,093,114.71 determined as follows:

Surplus as at March 1, 1913		$4,332,684.78
Subsequent Earnings	$2,455,282.92	
Less: Losses for years 1915 and 1916	404,846.99	
	$2,050,435.93	
Less: Dividends Paid	1,290,000.00	
Accumulated Surplus subsequent to March 1, 1913		760,435.93
Total Surplus as at April 14, 1923		$5,093,120.71

(b) That the Company on April 14, 1923, declared and paid a dividend of $340 per share on its 15,000 shares of Capital Stock outstanding, amounting to $5,100,000.00

(c) That the taxable portion of said dividend declared and paid on

April 14, 1923, out of surplus accumulated subsequent to March 1, 1913, amounted to $760,429.93 or 14.91% of the total distribution.

(d) That the total dividends received by this petitioner from the West Side Lumber Company on April 14, 1923, on his 3,270 shares of Capital Stock amounted to 3,270x$340 or $1,111,800.00

(e) That the taxable portion of said dividends received by this petitioner from the West Side Lumber Company on April 14, 1923, amounted to 14.91% of $1,111,800 or $165,769.38

[11] XIII.

The Commissioner of Internal Revenue erred in computing and proposing to assess a tax against this petitioner based on taxable income determined by including therein taxable dividends from the West Side Lumber Company in the aggregate amount of $278,505.90.

XIV.

The Commissioner of Internal Revenue erred in not finding that there was no deficiency in tax of this petitioner for the year 1923.

[12] XV.

The Commissioner of Internal Revenue erred in not finding that there was an overassessment of tax against this petitioner for the year 1923, determinable as follows:

Net Income reported on return		$189,032.72
Additions:		
(a) Decrease in partnership loss		1,327.99
(b) Decrease in donations		120.00
		$190,480.71
Deductions:		
(c) Decrease in taxable dividends received April 14, 1923, from West Side Lumber Company:		
Reported in return	$181,812.00	
Corrected (Item XI–e, *supra*)	165,769.38	
		16,042.62
Net Taxable Income adjusted		$174,438.09
Total Tax computed on $174,438.09		$ 58,434.66
Less: 25% reduction under the Revenue Act of 1924		14,608.66
Tax Liability		$ 43,826.00
Previously assessed		49,189.52
Overassessment		$ 5,363.52

[13] (5) The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a)

On or about January 24, 1924, the petitioner filed his income tax return for the taxable year 1923 in which he reported taxable income of $189,-032.72 determined as follows:

Salaries Received		$ 6,000.00
Interest Received		4,267.38
Dividends Received—		
West Side Lumber Company:		
Feb. 12, 1923—3,270 shares @ $10.00	$ 32,700.00	
Apr. 14, 1923—3,270 shares @ $55.60	181,812.00	
Brooklyn Edison Company	2,200.00	
Armour & Company	1,651.81	
Commonwealth Power pany	1,137.35	
Sunset Francis Oil Company	426.36	
Berkeley Bank	40.00	
		219,967.52
		$230,234.90
Deductions—		
Partnership Losses	$10,358.92	
Losses on Sale of Securities, etc.	19,849.01	
Interest Paid	2,371.37	
Taxes Paid	862.88	

Contributions	7,610.00	
Expenses	150.00	
		41,202.18
Net Income reported in return.....		$189,032.72

[14] (b)

The total tax computed by the petitioner for the year 1923 on taxable income of $189,032.72 amounted to $49,189.52, which amount the petitioner paid to the Collector of Internal Revenue, at San Francisco, California, in installments as follows:

Jan. 24, 1924, Paid to Collector	$32,793.02
Sept. 10, 1924, Paid to Collector	8,198.26
Dec. 11, 1924, Paid to Collector	8,198.24
	$49,189.52

(c)

The West Side Lumber Company is a California Corporation organized in 1889. The capital of the Company at March 1, 1913, and at April 14, 1923, was represented by 15,000 shares of capital stock having a par value of $100 each, and a book value as determined by the Commissioner and admitted by the petitioner, as follows:

	Mar. 1, 1913	Apr. 14, 1923
Capital Stock	$1,500,000.00	1,500,000.00
Surplus	4,332,684.78	5,093,120.71
Total Capital	$5,832,684.78	6,593,120.71
Value per share	$ 388.85	439.54

[15] (d)

On April 14, 1923, the West Side Lumber Company declared and paid to its stockholders a dividend of $340 per share on its 15,000 shares of capital stock, said dividends aggregating $5,100,000 and constituting a distribution of the entire surplus of the company, both as to surplus accumulated subsequent to March 1, 1913, and surplus accumulated prior thereto.

(e)

The petitioner owns 3,270 shares of the capital stock of the West Side Lumber Company which he acquired about 1906 and which he continuously owned up to and including April 14, 1923.

(f)

On April 14, 1923, the petitioner received from the West Side Lumber Company a dividend of $340 per share on his 3,270 shares of the capital stock of that company, amounting to $1,111,800.

[16] (g)

The fiscal year of the West Side Lumber Company ends on the last day of February in each year and the surplus of that company as at March 1, 1913, and April 14, 1923, has been computed by the Commissioner and admitted by the taxpayer as follows:

Surplus as at March 1, 1913.....		$4,332,684.78
Subsequent Earnings:		
Year ending February 28, 1914.....	$ 4,594.62	
Year ending February 28, 1915 Loss.....	(193,139.67)	
Year ending February 29, 1916 Loss.....	(211,707.32)	
Year ending February 28, 1917.....	60,495.56	
Year ending February 28, 1918.....	57,901.55	
Year ending February 28, 1919.....	208,737.34	
Year ending February 29, 1920.....	543,490.33	
Year ending February 28, 1921.....	640,837.43	
Year ending February 28, 1922.....	182,954.63	
Year ending February 28, 1923.....	718,858.29	
Year ending February 29, 1924 up to April 14, 1923—44/366ths of $311,209.54..	37,413.17	
		2,050,435.93
		$6,383,120.71

Less:		
Dividends Paid—		
Year ending February 28, 1918	$ 90,000.00	
Year ending February 29, 1920	75,000.00	
Year ending February 28, 1921	375,000.00	
Year ending February 28, 1922	300,000.00	
September 15, 1922	150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		1,290,000.00
Surplus at April 14, 1923		$5,093,120.71
Dividend paid April 14, 1923—		
15,000 shares @ $340 per share		$5,100,000.00

[17] (h)

The Commissioner has determined that the surplus of the West Side Lumber Company accumulated subsequent to March 1, 1913, and available for dividends on April 14, 1923, amounted to $1,165,276.92 and that the amount of surplus distributable exempt from tax on April 14, 1923, was $3,934,723.08. In arriving at these amounts the Commissioner has considered that the losses and depreciation sustained by the company during the two years ending February 28, 1915, and February 29, 1916, aggregating $404,846.99 should be deducted from the surplus accumulated prior to March 1, 1913, and not from the surplus accumulated subsequent to March 1, 1913. The taxpayer claims as a matter of fact that at least $404,846.99 of the earnings of the company for years following February 29, 1916, were used to make good the losses and depreciation for the two years ending February 28, 1915, and February 29, 1916, and in support of this contention submits the following facts:

(1) The surplus of the company at March 1, 1913, amounting to $4,332,684.78 was invested in timber and plant and was not in such form that it could be used to pay dividends or furnish working capital.

(2) During the years ending February 28, 1915, and February 29, 1916, the expenses of the company exceeded its income and in order to pay these expenses the company borrowed $700,000 by the issuance and sale of $700,000 First Mortgage 6% Serial Gold Bonds dated September 15, 1915. The

proceeds from sale of these bonds in September, 1915, amounted to $636,000 and such proceeds were used to pay expenses incurred in 1915 and 1916 and for working capital.

[18] (3) Out of the earnings in subsequent years the company paid this indebtedness by the redemption and cancellation of its bonds as follows:

Mar. 15, 1918 Bonds redeemed at maturity	$175,000.00
Sept. 15, 1920 Bonds redeemed at maturity	175,000.00
Feb. 28, 1921 Bonds purchased and retired	116,000.00
Feb. 28, 1922 Bonds purchased and retired	57,000.00
Feb. 28, 1923 Bonds purchased and retired	60,000.00
Mar. 15, 1923 Bonds purchased and retired	117,000.00
	$700,000.00

(i)

The losses and depreciation sustained by the West Side Lumber Company during the two fiscal years ending February 28, 1915, and February 29, 1916, which the Commissioner has deducted from surplus accumulated prior to March 1, 1913, were as follows:

	Year ending Feb 28, 1915	Year ending Feb. 29, 1916
Sales and Other Income	$675,738.85	646,732.42
Less: Costs and Expenses	$720,725.62	717,617.75
Depreciation and Depletion	148,152.90	140,821.99
	$868,878.52	858,439.74
Net Loss, carried to Surplus	$193,139.67	211,707.32

The excess of expenses over income was paid by the company out of funds obtained from the sale of bonds in 1915 and these bonds were thereafter paid out of the income of subsequent years. Depreciation and depletion charges as stated above are the amounts determined and allowed by the Commissioner for the purpose of returning to the company, out of income, the value of its property as of March 1, 1913.

[19] (j)

In filing his original tax return for the year 1923 the petitioner reported taxable dividends received from the West Side Lumber Company in the following amounts:

February 12, 1923—3,270 shares @ $10			$32,700.00
April 14, 1923—3,270 shares @ $340.00		$1,111,800.00	
Less: Nontaxable portion paid out of surplus accumulated prior to March 1, 1913 —3,270 shares @	284.40	929,988.00	
Taxable 3,270 shares @ .....$ 55.60			181,812.00
Taxable dividends from West Side Lumber Company reported by petitioner in original return.....			$214,512.00

Some time after petitioner filed his 1923 return in which he allocated the dividend of April 14, 1923, as above, the Commissioner examined the accounts of the corporation for all years up to February 29, 1924, and determined that the surplus of the company at March 1, 1913, amounted to $4,332,-684.78, and that at April 14, 1923, it amounted to $5,093,120.71, as shown by the computation set forth in Item (g) *supra* which the petitioner accepts as correct.

As a result of the Commissioner's revision of the surplus account of the company the petitioner contends that the dividends which he received in 1923 from the West Side Lumber Company should have been reported as follows:

Feb. 12, 1923—3,270 shares @ $10....		$ 32,700.00
Apr. 14, 1923—3,270 shares @ $340...	$1,111,800.00	
Taxable—14.91%		165,769.38
Total taxable dividends from West Side Lumber Company, as corrected		$198,469.38

[20] (k)

The total tax paid by the petitioner for the year 1923 amounted to $49,189.52 (Item (b) *supra*) whereas it is now his contention that the proper amount of such tax is not more than $43,826 and that instead of a deficiency of $36,720.96 for the year 1923 there was, in fact, an overassessment for that year amounting to $5,363.52 determinable as follows:

Net Income reported on return.....		$189,032.72
Additions:		
(a) Decrease in partnership loss.....		1,327.99
(b) Decrease in donations.....		120.00
		$190,480.00
Deductions:		
(c) Decrease in taxable dividend received during 1923 from the West Side Lumber Company as follows:		
Reported in return (Item a).....	$214,512.00	
Taxable Dividends corrected (Item j).....	198,469.38	
		16,042.62
Net Taxable Income as amended.....		$174,438.09

Total Tax computed on $174,438.09	$ 58,434.66
Less: 25% reduction under the Revenue Act of 1924	14,608.66
Tax Liability	$ 43,826.00
Previously Assessed	49,189.52
Overassessment	$ 5,363.52

[21] WHEREFORE, the petitioner prays that this Board may hear the claims of the petitioner; that it may redetermine the alleged deficiency in such notice of deficiency; that it may direct the Commissioner of Internal Revenue to recompute the tax liability of the petitioner for the year 1923 in conformity with the claims and matters hereinbefore set out; and that it may find that there is no deficiency in the tax returned and paid by this petitioner for the year 1923, but that he has, in fact, paid for the year 1923 a greater tax than was lawfully due from him.

WILLIAM R. THORSEN. (Petitioner.)
WILLIAM R. THORSEN,
1107 Crocker First National Bank Bldg.,
San Francisco, California.
EDWIN H. CASSELS. (Counsel.)
EDWIN H. CASSELS,
209 South LaSalle St.,
Chicago, Illinois.
ANDREW L. CAMPBELL. (Counsel.)
ANDREW L. CAMPBELL,
105 South LaSalle St.,
Chicago, Illinois.

[22] State of California,
County of San Francisco,—ss.

William R. Thorsen, being first duly sworn, on oath deposes and says that he is the petitioner named in the foregoing petition; that he has read said petition and that all the matters and things

therein stated are true and correct to the best of his knowledge, information and belief.

WILLIAM R. THORSEN.

WILLIAM R. THORSEN.

Subscribed and sworn to before me this 27th day of April, 1928.

[Seal] LEONTINE E. DENSON,

Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Dec. 3, 1931.

[23] EXHIBIT "A."

TREASURY DEPARTMENT,
Washington.
Office of
Commissioner of Internal Revenue.

Address Reply to
Commissioner of Internal Revenue
and Refer to
IT:CR:G-4-60D.
G. C.

March 6, 1928.

Mr. William R. Thorsen,
1107 First National Bank Building,
San Francisco, California.

Sir:

In accordance with Seetion 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the year 1923 discloses a deficiency of $36,720.96 as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the enclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN,
Deputy Commissioner.

Enclosures:

Statement.
Form A.
Form 882.
Schedules 1 and 2.

Form 7928—Jan. 1928. mer-3.
(461M)
[24] IT:CR:G-4-60D.
GC.

Exhibit "A"—Cont'd.

STATEMENT OF RETURNS EXAMINED
and
RESULTING TAX LIABILITY.

Return Examined.

Taxpayer	Year.	Form.	Date Filed.
William R. Thorsen, San Francisco, California	1923	1040	January 24, 1924

Tax Liability.

Taxpayer	Year.	Deficiency in Tax.
William R. Thorsen, San Francisco, California	1923	$36,720.96

The adjustments shown in the accompanying Schedules 1 and 2, disclosing this deficiency in tax have been made on the basis of facts and data now before the Unit in connection with a Revenue Agent's report dated March 25, 1927.

The change in the allocation of dividends set out in office letter dated November 17, 1927, is due to the reallocation being made in accordance with the decisions of the United States Supreme Court in the Routzehn vs. Mason Case.

Reference is made to your contention as set out in your briefs dated January 14, 1928 and February 10, 1928 and the conference held in this office January 20, 1928 that the operating losses of the corporation during its fiscal years ended February 28, 1915 and 1916 should operate to reduce the surplus accumulated subsequent to February 28, 1916 available for taxable dividends. Careful consideration has been given to the arguments but it is held that all of the surplus earned subsequent to February 28, 1916 was available for taxable dividends.

mer–3.

[25] IT:CR:G-4-60D.

Exhibit "A" Cont'd.

-2-

GC.

Statement—continued.

In re: Mr. William R. Thorsen.

A consent extending the period to December 31, 1928, during which assessment may be made is on file.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

A carbon copy of this letter is being mailed to Mr. Andrew L. Campbell, Chicago, Illinois, in accordance with your power of attorney running to him which is on file in this office.

mer-3.

Exhibit "A"—Cont'd.

-1-

[26] William R. Thorsen.

Year ended December 31, 1923.

Schedule 1.

Net Income reported on return	$189,032.72
Net Income adjusted	287,174.61
Additions	$ 98,141.89

Additions:

(a)	Decrease in partnership loss	$ 1,327.99

(b) Decrease in donations $ 120.00
(c) Increase in Taxable Dividends 96,693.90

Total additions as above ...$98,141.89

Explanation of Changes Made.

(a) The changes in the partnership income were explained in detail in the Revenue Agent's report on the partnership, Petrolia Oil Company, dated March 25, 1927.

(b) This item represents a contribution to the Anti-Saloon League which does not come within the purview of Section 214(a)11 of the Revenue Act of 1921.

(c) Taxable dividends from West Side Lumber Company:

Corrected $278,505.90
Reported on return 181,812.00

Addition .....$ 96,693.90

Of the total dividends received by you during this year 25.05% have been allocated as taxable. Since you received $1,111,800.00 the amount taxable on your return is $278,505.90.

mer–3.

[27] William R. Thorsen.

Exhibit "A"—Cont'd.

-2-

Year ended December 31, 1923.

Schedule 2.

Net Income adjusted		$287,174.61
Less: Dividends		316,661.42
Income subject to normal tax		None
Surtax on $287,174.61		$114,547.30
Less: 25% reduction under the Revenue Act of 1924		28,636.82
Tax Liability		$ 85,910.48
Tax previously assessed	$65,586.03	
Less: 25% reduction under the Revenue Act of 1924	16,396.51	
		49,189.52
Deficiency in tax		$36,720.96

[28] Filed Jul. 2, 1928. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER.

Comes now the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition of this taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies the allegations of error contained in subdivisions I to IV, inclusive, of Paragraph 4 of the petition.

5. (a) Admits that the petitioner filed his return for the year 1923 on or about January 24, 1924, in which he reported taxable income of $189,032.72. Denies each and every other allegation of fact contained in subdivision (a) of Paragraph 5 of the petition.

(b) Denies the allegations of fact contained in subdivision (b) of Paragraph 5 of the petition.

(c) Admits that the West Side Lumber Company is a California Corporation. For want of information denies each and every other allegation of fact contained in subdivision (c) of Paragraph 5 of the petition.

(d) Admits that in April, 1923, the West Side Lumber Company paid a dividend of $5,100,000 or $340 a share. Denies each and every other allegation of fact contained in subdivision (d) of Paragraph 5 of the petition.

[29] (e) Admits that the petitioner owns 3,270 shares of the capital stock of the West Side Lumber Company. For want of information denies each and every other allegation of fact contained in subdivision (e) of Paragraph 5 of the petition.

(f) Admits that in April, 1923, petitioner received in such distribution the sum of $1,111,800. Denies each and every other allegation of fact contained in subdivision (f) of Paragraph 5 of the petition.

(g) For want of information denies the allegations of fact contained in subdivision (g) of Paragraph 5 of the petition.

(h), (i), (j), (k). Denies the allegations of fact contained in subdivisions (h), (i), (j) and (k) of Paragraph 5 of the petition.

Denies generally and specifically each and every allegation of error and of fact contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
A. H. FAST,
Special Attorney,
Bureau of Internal Revenue.

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[30] Filed at Hearing Oct. 30, 1930. U. S. Board of Tax Appeals. Div. 4. Docket 38,095.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

MEMORANDUM OF FACTS.

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that, for the purpose of this proceeding, the following facts may be accepted as true:

1.

The items of gross income, the deductions therefrom, and the net income shown in petitioner's 1923 return were as follows:

Gross Income.

Salaries received		$ 6,000.00
Interest received		4,267.38
Dividends received		219,967.52
		230,234.90

Deductions.

Partnership losses	$10,358.92	
Loss on sale of securities	19,849.01	
Interest paid	2,371.37	
Taxes paid	862.88	
Contributions	7,610.00	
Expenses	150.00	
		41,202.18
Net income shown in petitioner's 1923 return		$189,032.72

[31] 2.

The item of dividends amounting to $219,967.52 included in gross income in the petitioner's 1923 return consisted of—

Dividends received from the West Side Lumber Company on or about February 12, 1923, amounting to $10 a share on 3,270 shares, or	$32,700.00
Dividends received from the West Side Lumber Company on or about April 14, 1923, amounting to $340 a share on 3,270 shares, or $1,111,800, of which the petitioner reported as	

taxable income an amount equal to $55.60 a share on 3,270 shares, or	$181,812.00
Dividends received from other corporations	5,455.52
Total taxable dividends shown in petitioner's 1923 tax return.....	$219,967.52

3.

The determination of tax set forth in the Commissioner's notice of deficiency was arrived at by the computations shown in Exhibit "A" attached to the petition which is a true and correct copy of the Commissioner's letter dated March 6, 1928.

4

The computation by which the Commissioner determined that the the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 25.05% taxable is set forth in a letter from the Commissioner dated January 6, 1928, in words and figures as follows:

[32] 4. (Continued)

TREASURY DEPARTMENT,
Washington.

IT:CR:G-4.
GC.

Jan. 6, 1928.

Mr. William R. Thorsen,
1107 First National Bank Building,
San Francisco, California.

Sir,

Reference is made to your brief dated November

30, 1927, in which you requested the computation of taxable dividends received by you from the West Side Lumber Company during the calendar year 1923 as shown in office letter dated November 17, 1927.

The allocation shown in office letter dated November 17, 1927, has been revised to the following as explained in office letter dated December 15, 1927:

Date paid	Taxable	Non-taxable
February 12, 1923	100%)	
	) Average	25.05%
April 14, 1923	22.85%)	77.15%

In accordance with the authority contained in a telegram from the West Side Lumber Company dated December 1, 1927, the following information is submitted:

Undistributed earnings accumulated subsequent to March 1, 1913, available for dividends February 28, 1922		$859,011.46
Earnings for the fiscal year ended February 28, 1923, available for dividends		718,858.29
		1,577,869.75
Dividends paid—		
September 15, 1922	$150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		450,000.00

Undistributed earnings accumulated subsequent to March 1, 1913, available for dividends March 1, 1923	$1,127,869.75
Earnings for the fiscal year ended February 29, 1924, up to April 14, 1923 (44/366 of $311,209.54 total for year)	37,413.17
Total earnings accumulated subsequent to March 1, 1913, available for dividends April 14, 1923	1,165,282.92

[33] 4. (Continued)

Brought forward	$1,165,282.92
Dividends paid April 14, 1923	5,100,000.00
Amount paid April 14, 1923, out of earnings not accumulated subsequent to March 1, 1913 (non-taxable)	$3,934,717.08

A carbon copy of this letter has been mailed to Mr. Andrew L. Campbell, Chicago, Illinois, in accordance with your power of attorney running to him which is on file in this office.

Respectfully,

C. B. ALLEN,
Deputy Commissioner,
By (Signed) H. G. NICHOLS,
Chief of Section.

5.

The respondent concedes that the computation shown in letters dated January 6, 1928, and March 6, 1928, should be revised to show that the dividend

of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 22.75% taxable instead of 25.05% taxable, determined as follows:

Statement of West Side Lumber Company Surplus Account March 1, 1913, to April 14, 1923.

Surplus March 1, 1913		$4,332,684.78
Add:		
Profit for year ended February 28, 1914		4,594.62
		4,337,289.40
Deduct:		
Loss for year ended February 28, 1915	$193,139.67	
Loss for year ended February 29, 1916	211,707.32	
		404,846.99
Surplus February 29, 1916, carried forward		$3,932,442.41

[34] 5. (Continued.)

Surplus February 29, 1916, brought forward.....	$3,932,442.41
Subsequent earnings:	
Year ended February 28, 1917.....	60,495.56
Year ended February 28, 1918.....	57,901.55
Year ended February 28, 1919.....	208,707.34
Year ended February 29, 1920.....	543,490.33
Year ended February 28, 1921.....	640,837.43
Year ended February 28, 1922.....	182,954.63
Year ended February 28, 1923.....	718,858.29
Period ended April 14, 1923 (44/366 of $311,209.54 total for year ended February 29, 1924).....	37,413.17
Total earnings March 1, 1916, to April 14, 1923...	$2,450,658.30

Less:		
Dividends paid:		
Year ended February 28, 1918	$ 90,000.00	
Year ended February 28, 1920	75,000.00	
Year ended February 28, 1921	375,000.00	
Year ended February 28, 1922	300,000.00	
Year ended February 28, 1923	450,000.00	
		1,290,000.00
Surplus March 1, 1916, to April 14, 1923 (22.75% of $5,100,000)		1,160.658.30
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		$3,939,341.70

6.

The capital stock of the West Side Lumber Company during the period from March 1, 1913, to April 14, 1923, consisted of 15,000 shares having a par value of $100 each. The petitioner owned 3,270 shares of said capital stock during all of such period.

[35] 7.

The surplus of the West Side Lumber Company and it's earnings, losses, and dividends for the period from March 1, 1913, to April 14, 1923, were as follows:

Statement of West Side Lumber Company Surplus Account March 1, 1913, to April 14, 1923.

Surplus March 1, 1913		$4,332,684.78
Subsequent Earnings:		
Year ended February 28, 1914—Profit	$ 4,594.62	
Year ended February 28, 1915—Loss	(193,139.67)	
Year ended February 29, 1916—Loss	(211,707.32)	
Year ended February 28, 1917—Profit	60,495.56	
Year ended February 28, 1918—Profit	57,901.55	
Year ended February 28, 1919—Profit	208,737.34	
Year ended February 29, 1920—Profit	543,490.33	
Year ended February 28, 1921—Profit	640,837.43	
Year ended February 28, 1922—Profit	182,954.63	
Year ended February 28, 1923—Profit	718,858.29	
Period ended April 14, 1923—Profit (44/366 of $311,209.54 total for year ended February 29, 1924)	37,413.17	

		2,050,435.93
		6,383,120.71
Dividends paid:		
Year ended February 28, 1918	$ 90,000.00	
Year ended February 29, 1920	75,000.00	
Year ended February 28, 1921	375,000.00	
Year ended February 28, 1922	300,000.00	
September 15, 1922	150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		1,290,000.00
Surplus April 14, 1923		$5,093,120.71

8.

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock, of which the petitioner received $1,111,800.

[36] The right is hereby reserved by both parties to prove any additional facts not inconsistent herewith.

WILLIAM R. THORSEN,
Petitioner.
By ANDREW L. CAMPBELL,
Attorney.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
By C. M. CHAREST,
Attorney.

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[37] 24 B. T. A. ——.

United States Board of Tax Appeals.

DOCKET Nos. 34,131, 38,095.

Promulgated October 27, 1931.

CHARLES J. CANFIELD,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

EDWIN H. CASSELS, Esq., and ANDREW L. CAMPBELL, C. P. A., for the Petitioners.

HAROLD ALLEN, Esq., and WILLIS R. LANSFORD, Esq., for the Respondent.

The Commissioner determined a deficiency in in-

come tax for 1923 of $9,243.66 in Docket No. 34,-131 and of $36,720.96 in Docket No. 38,095, the full amount of such deficiencies being in controversy.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[38] These proceedings are consolidated for hearing, the issue, which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

FINDINGS OF FACT.

The petitioners are individuals, Charles J. Canfield, residing and having his principal office in Chicago, Ill., and William R. Thornsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year Ended.	Profits.	Losses.
February 28, 1914	$ 4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	$ 60,495.56	
February 28, 1918	$ 57,901.55	
[39]		
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
	$2,455,282.92	$404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$ 90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00

September 18, 1922	$150,000.00
February 12, 1923	150,000.00
Total	$1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as [40] dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5,455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 per cent taxable, instead of being 28.217 per cent taxable in the case of Charles J. Canfield and 25.05 per cent taxable in the case of William R. Thorsen, as formerly asserted.

The petitioners contend that said dividend distribution was only 14.91 per cent taxable and that each reported originally more taxable income than he should have returned.

OPINION.

SEAWELL.—The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

> Sec. 201. (a) That the term "dividend" when used in this title * * * means any distribution made by a corporation [41] to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 29, 1913, * * *.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since

February 28, 1913, have been distributed.

* * *

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the Act exempt from the tax; that the surplus so created and existing can not be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913," which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913," as considered in O. D. 610, C. B. 3, p. 24, and A. R. M. 82, C. B. 3, p 36, and as likewise construed by the respondent and applied in the instant cases.

[42] The respondent in making his determination excludes from consideration for the period "since February 28, 1913," the losses (except to the extent of $4,594.62, profits for the year ending February 28, 1914), sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended

February 29, 1916, of $211,707.32. To March 1, 1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40 from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,688.30. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,688.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000. The difference between the $1,160,688.30 and the $5,100,000 declared and paid as a dividend April 14, 1923, is $3,939,311.70 and represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as dividends in the hands of the recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen, $1,111,800, and [43] if the respondent's method to tax computation is correct, each of the petitioners is taxable on 22.75 per cent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

In the year ended February 28, 1914, the company made a profit of $4,594.62 and if it had then, out of its total earnings or surplus, declared a dividend and made distribution even in excess of the $4,594,62, but less than the entire surplus, the whole dividend would have been taxable to the recipients thereof. The revenue law exempting from taxation dividends declared out of earnings accumulated prior to March 1, 1913, was not enacted until September 8, 1916. In Lynch vs. Hornby, 247 U. S. 339 (decided June 3, 1918), the court said:

> We repeat that under the 1913 Act dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

No dividend was declared, however, out of the earnings for the year ending February 28, 1914, and it was accordingly proper for the corporation to add that sum, $4,594.62, to its accumulated surplus, bringing it to the sum of $4,337,279.40. When in the two succeeding years there were operating losses by the corporation charged, of course, against surplus, the surplus was reduced by the sum of the losses, $404,846.99, resulting in a new surplus on February 29, 1916, of $3,932,432.41.

The treatment to be accorded this new surplus and the earnings and profits thereafter accumulated by the corporation contains the matter in [44] controversy here. The petitioners contend that since

the new surplus is less than the surplus existing at March 1, 1913, all subsequent earnings and profits of the corporation should be added to this new surplus until it equals the surplus on hand at March 1, 1913, before dividends paid to stockholders are taxable.

In other words, the petitioners contend that they are not taxable on any dividend declared and paid at any time after March 1, 1913, although the corporation has had gains in that period, if for any cause, the corporation's surplus is less than what it was on that basic date; and they urge on us the construction of the clause of the statute "earnings or profits accumulated since February 28, 1913," that a period of all the years since March 1, 1913, should be considered together to ascertain whether there have been net accumulations for the whole period. It is elementary that the different parts of a statute are to be considered *in pari materia.* Certainly no part of a statute should be so interpreted as to annul any other part. When the statute provides that "every distribution is made * * * from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913," there is implied that some earnings or profits may belong to a class accumulated more recently than others. If all the years since March 1, 1913, are to be taken together and additions and subtractions made to ascertain if earnings or profits have "accumulated" and the amount thereof during the period, then there would not seem to be much reason for ascertaining the nearness or remoteness

of such [45] earnings or profits. It could make no difference whether the distributions or dividends were from the most receit or most remote accumulations, since they all lie in one hodgepodge. Surely Congress had some reason for inserting in the statute the provision as to the most recent accumulations. All income taxing statutes under the Sixteenth Amendment are based on yearly periods, either calendar or fiscal years. Returns are so made out and gains and losses calculated so as to show profit or loss during the year, and for such a period it is immaterial which part of the gain is more recent or remote. It would seem singular if Congress did adopt the yearly period in taxation matters for all times and under all circumstances, except at the time of the enactment of the statute now under consideration and then only for part of the statute. It is more consonant with reason to suppose that Congress when it provided for "accumulations since February 28, 1913," had reference to accumulations in yearly periods. A contrary interpretation of the taxing law has been sought without success. In Edwards vs. Douglas, 269 U. S. 204, 217, the court said, in interpreting similar provisions of the Revenue Act of 1917, section 31 (b):

> * * * To accomplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." * * *

The Supreme Court in another case later said:

> * * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, [46] if combined in a single taxable period might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or loss.
>
> Burnet vs. Sanford & Brooks Co., 282 U. S. 359.

The only losses of the West Side Lumber Company were for the years ending February 28, 1915, and February 29, 1916. The petitioners, who received dividends in 1923 from the corporation, contend in effect that the losses for those two years should be carried forward and deducted from gains in the years ending February 28, 1917, 1918, 1919 and 1920. The Revenue Act of 1918, section 204, permitted a net loss in one year to be carried to the preceding year to reduce the income in that year, and if in excess of such income for the preceding year, to have such excess carried forward to the succeeding year for a similar purpose as to the income in the succeeding year. But we know of no such provision of law applicable to the years here involved, and the Act of 1918 is not retroactive, or claimed by petitioners so to be. There was at the

time of these losses, which aggregate $404,846.99, no operating deficit of the corporation, but an undivided surplus, as before stated, of $4,337,279.40, all of which, except $4,594.62, was accumulated prior to March 1, 1913. The undivided surplus, therefore, was adequate to take care of the operating losses in the two years mentioned, without in any way impairing the capital of the corporation, which amounted to $1,500,000.

[47] The petitioners cite two recent court decisions which they insist sustain their contentions, viz., Leland vs. Commissioner, 50 Fed. (2d) 523, and Hadden vs. Commissioner, 49 Fed. (2d) 709. In the Leland case, first cited, the Board of Tax Appeals, 18 B. T. A. 795, is affirmed. In the opinion of the court it is said:

> Then again, as the Leland-Gifford Company had on hand, at the time the distributions were made, earnings or profits that had accumulated since 1913, we do not think that the provisions of section 201 (c) of the Revenue Act of 1921 and 1924 are applicable.

This case does not appear to be an authority for the petitioner. In the case of Hadden vs. Commissioner, *supra,* the corporation never had a surplus, but operating losses from its organization in 1904, in each year until April 30, 1917, at which time the net deficit was $833,862.92. The total losses between March 1, 1913, and April 30, 1917, were $329,549.22. From April 30, 1917, to December 20, 1917, by the sale of capital assets, it had a taxable profit of $405,-949.07. The court held that the operating losses or

carrying charges after March 1, 1913, should be deducted from the profits of December 20, 1917, before dividends declared and paid out of such taxable profits were taxable to the stockholders receiving the dividends. What the court would have held if, as in the case at bar, the corporation had had accumulated surplus and undivided profits sufficient to have absorbed all the losses before the profits by sale of the capital assets were realized, it is mere speculation to surmise; but the facts in that case are so different in material respects from those in [48] the instant case that we do not feel impelled to follow certain of the language used by the learned judge who delivered the opinion, even though it might be broad enough to include a situation comparable to that before us.

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 28.217 per cent taxable, but insists upon the application in the instant cases of the principle adopted and maintained for many years by the Bureau of Internal Revenue and set forth in G. C. M. 3532, C. B. VII–1, 190, which position we think correct and we so expressed ourselves in Louise Glassell Shorb, 22 B. T. A. 644, 645, in which case the Commissioner had taken an opposite view. We are of the opinion that the principle so approved is also sustained in Blair vs. United States, 63 Ct. Cls. 193; certiorari denied 275 U. S. 546.

We are of the opinion that the deficiencies pro-

posed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct.

Reviewed by the Board.

Judgment will be entered in each case under Rule 50.

[49] TRAMMELL, Dissenting.—It seems to me too clear for controversy that any surplus existing at February 28, 1913, has no connection whatever with what the accumulated surplus since that date is. What the majority opinion holds might be illustrated as follows: If a taxpayer had an earned surplus of $10,000 on February 28, 1913, and subsequent to that date had earnings in some years, and losses in others, and at the end of 1920 the total losses since February 28, 1913, equaled its total earnings since that date, with the result that at that time there were no earnings in fact accumulated since 1913, a distribution at the close of 1920 would be held to be out of the earnings or profits accumulated since February 28, 1913. In other words, the losses since February 28, 1913, are applied against the surplus existing on that date. Yet in the illustration given it is perfectly plain that the only surplus to be distributed was that existing on February 28, 1913. This, in my opinion, results in taxing the surplus existing on February 28, 1913, when distributed in dividends, contrary to the statute. In my opinion there can be no accumulated surplus since February 28, 1913,

unless the earning since that date exceed the losses since that date. These are the only factors to be considered. I see no occasion to apply losses since 1913 to surplus at that time in order to ascertain the accumulated earnings since February 28, 1913. This is quite different from the principle of determining earned surplus for invested capital purposes, where there is no requirement to determine accumulated surplus since a certain date, but only the question as to the total earned surplus existing in the taxable year or on hand when that year began. See Willcuts vs. Milton Dairy Co., 275 U. S. 215. [50] I believe the statute should be construed according to its plain language, that is, the distribution to be taxable must be out of earnings or profits accumulated since February 28, 1913, and that such amount should not be affected in any way by any surplus existing at that time.

The losses since February 28, 1913, should be taken from the profits since that date to determine the accumulated profits since that date.

I do not think the Shorb case in 22 B. T. A. 644, is authority for the majority decision. The corporation in that case was not organized until after March 1, 1913.

The prevailing opinion also relies on the case of Blair vs. United States, 63 Ct. Cls. 193 (A. F. T. R. 6552). In the case of J. L. Washburn, 16 B. T. A. 1091, the Board pointed out that it considered the Blair case to be unsound and declined to follow it.

In the case of Hadden vs. Commissioner, 49 Fed.

(2d) 709 (A. F. T. R., vol. 9, 1497), the Circuit Court of Appeals for the Second Circuit, said:

> The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *.

I think this view is correct and that it is erroneous to reduce the surplus on hand on February 28, 1913, by subsequent losses to determine the earnings and profits accumulated since that date.

MORRIS, MARQUETTE, SMITH, STERNHAGEN, LOVE, and McMAHON agree with this dissent.

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[51] United States Board of Tax Appeals,
Washington.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the findings of fact and opinion of the Board promulgated October 27, 1931, the respondent, on November 23, 1931, filed notice of settlement under Rule 50. Copy of said notice having been served on the petitioner and the peti-

tioner on December 16, 1931, having filed notice of acquiescence to the proposed settlement, it is

ORDERED and DECIDED: That there is a deficiency in tax for the year 1923 in the amount of $27,131.69.

(Signed) H. F. SEAWELL,
Member.

Entered Dec. 19, 1931.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

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[52] Filed April 16, 1932.

In the United States Circuit Court of Appeals for the Ninth Circuit.

B. T. A. No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,

Respondent.

PETITION FOR REVIEW.

Comes now William R. Thorsen, by Edwin H. Cassels and Barry Gilbert, his attorneys, and respectfully shows unto this court that:

A.

1. The petitioner is a citizen of the United States

and of the State of California, with his residence in Berkeley, California.

2. On or about the 24th day of January, 1924, the petitioner filed in the office of the Collector of Internal Revenue at San Francisco, California, his detailed income tax return for the calendar year 1923 and reported therein a net taxable income of $189,032.72 for said year 1923. Included in such return was an item of $181,812, returned as taxable income from a certain dividend received by him on or about April 14, 1923, from West Side Lumber Company, a California corporation.

[53] 3. West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares, having a par value of $100 each. The petitioner during all of such period owned 3,270 shares of said capital stock.

4. In addition to its said original capital of $1,500,000, West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78 and the book value of its common stock was on that date $388.85 per share.

5. On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913, so that the book value of the common stock on April 14, 1923, was $439.54 per share.

6. The earnings and losses of the company after March 1, 1913, were as follows:

Year Ending.	Profits.	Losses.
February 28, 1914	$ 4,594.62	
February 28, 1915		$133,139.67

February 29, 1916		$211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
March 1, 1923, to April 14, 1923 (44/336 of $311,209.54)	[illegible],413.17	
Total	$2,455,282.92	$404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

[54] 7. The following dividends were paid by West Side Lumber Company after February 28, 1913:

Period.	Per Share.	Amount.
Year ended Feb. 28, 1918	$ 6	$ 90,000.00
Year ended Feb. 29, 1920	5	75,000.00
Year ended Feb. 28, 1921	25	375,000.00
Year ended Feb. 28, 1922	20	300,000.00
September 15, 1922	10	150,000.00
September 18, 1922	10	150,000.00
February 12, 1923	10	150,000.00
		$1,290,000.00

8. On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000 or $340 a share on its 15,000 shares of capital stock. The petitioner received from this source

from his said 3,270 shares, the sum of $1,111,800. The issues in this case concern the taxable income due from the said William R. Thorsen with respect to this payment received by him.

9. The Commissioner of Internal Revenue, by his letter dated January 6, 1928, addressed to the petitioner, found that of the said $5,100,00 paid by the said dividend of West Side Lumber Company of April 14, 1923, $3,934,717.08 was paid out of surplus earned prior to March 1, 1913, and that the balance thereof, or $1,165,282.92, was paid out of the earnings of such company accumulated after February 28, 1913. This latter amount is 22.85% of the dividend paid on April 14, 1923. The Commissioner in such letter declared that such 22.85% of the dividend of April 14, 1923, represented taxable income to the petitioner under the provisions of Section 201 of the Internal Revenue Act of 1921.

[55] 10. Thereafter, on March 6, 1928, the Commissioner of Internal Revenue issued and mailed to the petitioner a deficiency letter from which the appeal to the Board of Tax Appeals hereinafter mentioned was prosecuted, and therein determined that the earnings accumulated after February 28, 1913, by West Side Lumber Company were approximately $1,277,550, or 25.05% of the dividend paid on April 14, 1923, and that the petitioner was therefore taxable under the provisions of Section 201 of the Internal Revenue Act of 1921 upon 25.05% of the dividend of $340 per share, or $278,505.90, received with respect to his said 3,270 shares.

11. In his said income tax return for the said calendar year of 1923, the petitioner had reported as taxable income the amount of $55.60 per share under his interpretation of Section 201 of said Internal Revenue Act of 1921. The said sum of $278,505.90 arrived at by the said Commissioner amounted to $85.17 per share. The issues thus presented between the Commissioner and this petitioner as a result of said deficiency letter were as to whether or not the difference between these two sums per share, on each of said 3,270 shares, or $29.57 per share, constituted taxable income to the petitioner for the year 1923.

12. Thereafter, the petitioner appealed from said determination of said Commissioner to the United States Board of Tax Appeals (Docket No. 38,095). The said Commissioner duly appeared therein and filed a stipulation [56] that his prior computations set forth in said letters of January 6, 1928, and March 6, 1928, were incorrect and that the said dividend of $340 per share paid by West Side Lumber Company on April 14, 1923, to this petitioner, with respect to each of his said 3,270 shares, was not to exceed 22.75% taxable, or at the rate of $77.35 per share or a total of $252,934.50.

13. Thereafter, the appeal of the petitioner was duly heard by said Board of Tax Appeals, which, on, to wit, the 27th day of October, 1931, promulgated its findings of fact and opinion in said proceeding and therein found and gave its opinion (eight members of said Board concurring therein, and seven members of said Board dissenting there-

from) that said dividend of $340 per share paid by West Side Lumber Company to this petitioner on April 14, 1923, with respect to each of his said 3,270 shares was 22.75% taxable.

14. The Board ordered that judgment be entered in said case under Rule 50 of said Board of Tax Appeals and pursuant thereto an order was subsequently entered finding that the total tax due from this petitioner for said year 1923 was $76,321.21, of which $49,189.52 had been previously assessed, leaving a balance of $27,131.69 for which judgment was entered by said Board under said Rule 50.

15. This petitioner claims that:

(a) This case is governed by Section 201 of the Internal Revenue Act of 1921.

[57] (b) West Side Lumber Company was entitled thereunder to distribute tax free all earnings and profits accumulated or increase in value in property accrued prior to March 1, 1913. Such earnings or profits were a sum equivalent to its surplus on February 28, 1913, namely, $4,332,684.78, and this sum was therefore distributable exempt from tax.

(c) The "earnings and profits" of West Side Lumber Company for the period March 1, 1913, to April 14, 1923, inclusive, were the difference between the total profits of the parts of such period in which profits were made ($2,455,282.92), and the total losses for the parts of such period in which losses were sustained ($404,846.99), namely, $2,050,435.93.

These net earnings so computed were the "earnings and profits" of West Side Lumber Company, "accumulated since February 28, 1913," within the meaning of Section 201 of the Internal Revenue Act of 1921.

(d) $1,290,000 of this amount having been distributed as dividends prior to April 14, 1923, the remainder of such amount, or $760,435.93, was distributed by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share, and having been "accumulated since February 28, 1913," was taxable income to [58] the several recipients thereof to the extent received by each.

(e) This sum of $760,435.93 was 14.91% of the total distribution of $15,100,000 ($340 per share) made April 14, 1923, by West Side Lumber Company, and therefore such distribution of $340 per share was 14.91%, or $50.694 per share, taxable to the several recipients within the meaning of Section 201 of the Internal Revenue Act of 1921.

(f) The "earnings and profits accumulated since February 28, 1913," having been thus distributed, the balance of the distribution made by the dividend of $340 per share on April 14, 1923, was free from tax in the hands of the recipients thereof under the provisions of Section 201 of the Internal Revenue Act of 1921.

(g) The taxable portion of the dividend of April 14, 1923, received by the petitioner from West Side Lumber Company was only 14.91% thereof, or approximately $165,769.38, which is

$16,042.62 less than was actually returned by him in his income tax return for 1923.

(h) There was no deficiency of tax as to 1923 on the part of the petitioner.

(i) There was no deficiency in tax for the year 1923. Instead, the petitioner paid for that year a tax of $49,189.52, whereas the proper [59] amount of his tax for that year was $43,826. He thus overpaid the sum of $5,363.52, which he is now entitled to have refunded to him.

16. The facts upon which the petitioner relies are those facts that are set out *in extenso* in the findings of fact of said Board of Tax Appeals promulgated on October 27, 1931, which are hereby by reference incorporated in and made a part of this petition with as full force and effect as though set forth *in haec verba* herein. The statements hereinbefore made are also relied upon and are in form a restatement of the findings of fact of the Board of Tax Appeals.

17. Briefly, the nature of this controversy is the question as to the meaning of Section 201 of the Internal Revenue Act of 1921 and in particular as to whether or not losses sustained in specific years following February 28, 1913, are to be deducted from profits gained in other years of such periods since February 28, 1913, in determining the "earnings and profits accumulated since February 28, 1913."

B.

The petitioner hereby assigns the following er-

rors with respect to the decision of said Board of Tax Appeals.

1. That said Board erred in finding that the dividend paid by West Side Lumber Company on April 14, 1923, was 22.75% taxable upon the 3,270 shares of its capital stock held by the petitioner, under the provisions of Section 201 of the Revenue Act of 1921.

[60] 2. That said Board erred in not finding that the dividend paid by West Side Lumber Company on April 14, 1923, was only 14.91% taxable upon the 3,270 shares of its capital stock held by the petitioner, under the provisions of Section 201 of the Revenue Act of 1921.

3. That said Board erred in failing to deduct the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

4. That said Board erred in so interpreting Section 201 of the Internal Revenue Act of 1921 as to require the exclusion of the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

5. That said Board erred in not finding that the entire surplus of West Side Lumber Company of $4,332,684.78 on March 1, 1913, was distributable

by it to its stockholders without tax to such stockholders.

6. That said Board erred in finding that only 77.25% of the dividend paid by West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913.

7. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year of 1923 all of his taxable income for that year.

[61] 8. That said Board erred in not finding that the petitioner included in his income tax return as taxable income for the calendar year 1923, $16,042.62 more of taxable dividends than he actually received during that year.

9. That said Board erred in not finding that the total earnings and profits of West Side Lumber Company accumulated since February 28, 1913, within the meaning of Section 201 of the Internal Revenue Act of 1921 were $2,050,435.93.

10. That said Board erred in not finding that only $760,435.93 of the distribution made by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share was accumulated since February 28, 1913, and taxable as income to the several recipients thereof.

WHEREFORE, this petitioner respectfully prays that the said decision and order of the Board of Tax Appeals may be reviewed by the Circuit Court of Appeals for the Ninth Circuit as by statute provided; that the said decision and order of

the Board of Tax Appeals be reversed with a finding that there is no deficiency in the amount of income tax paid by the petitioner for the year 1923; that the petitioner's tax for 1923 be properly recomputed; and that judgment be entered in favor of the petitioner for the excess heretofore paid by him beyond such proper tax.

WILLIAM R. THORSEN.
By EDWIN H. CASSELS,
BARRY GILBERT,
His Attorneys.

[62] State of California,
County of San Francisco,—ss.

William R. Thorsen, being first duly sworn, on oath deposes and says that he is the petitioner herein; that he has read the foregoing petition for review of the decision of the United States Board of Tax Appeals, and that all the facts therein stated are true and correct.

WILLIAM R. THORSEN.

Subscribed and sworn to before me this 29th day of March, A. D. 1932.

[Seal] LEONTINE E. DENSON,
Notary Public in and for San Francisco County, California.

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[63] Filed Apr. 16, 1932. United States Board of Tax Appeals.

Received Apr. 16, 1932. U. S. Board of Tax Appeals.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,

Respondent.

PRAECIPE FOR TRANSCRIPT OF RECORD.

To the Clerk of the Board of Tax Appeals:

You will please prepare the record in the above-entitled proceeding, which is an appeal from a decision of the Board of Tax Appeals promulgated October 27, 1931, in the proceeding entitled "William R. Thorsen, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket 38,095," and transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, sitting at San Francisco, California, duly certified copies of the following documents:

1. All docket entries of proceedings before the Board of Tax Appeals in said proceeding.

2. Pleadings therein before the Board of Tax Appeals.

3. Findings of fact, opinion and decision therein of the Board of Tax Appeals.

[64] 4. Petition for review of said decision.
5. The stipulation of facts entered into by the petitioner and the respondent in said proceeding.

Respectfully,
EDWIN H. CASSELS,
BARRY GILBERT,
Attorneys for William R. Thorsen.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CERTIFICATE OF CLERK U. S. BOARD OF TAX APPEALS TO TRANSCRIPT OF RECORD.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 64, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the praecipe in the appeal (or appeals) as above numbered and entitled.

IN TESTIMONY WHEREOF, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29th day of April, A. D. 1932.

[Seal] B. D. GAMBLE,
Clerk.

[Endorsed]: No. 6838. United States Circuit Court of Appeals for the Ninth Circuit. William R. Thorsen, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed May 9, 1932.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6838

United States
Circuit Court of Appeals
For the Ninth Circuit

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Wednesday, the eighth day of March, in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding, Honorable WILLIAM H. SAWTELLE, Circuit Judge, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER OF SUBMISSION.

ORDERED above cause argued by Mr. Edwin H. Cassels, counsel for the petitioner, and by Mr. Hayner N. Larson, Special Assistant Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Friday, the nineteenth day of May, in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: Honorable WILLIAM H. SAWTELLE, Circuit Judge, Presiding, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the Court, ORDERED that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

[Title of Court and Cause.]

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Before: WILBUR, SAWTELLE and MACK, Circuit Judges.

MACK, Circuit Judge:

Review is sought of a decision of the Board of Tax Appeals, affirming, except with respect to a concededly erroneous computation, a determination by the Commissioner of Internal Revenue of the deficiency in petitioner's 1923 income taxes. Petitioner asserts that there was no deficiency.

The sole question is how much of the dividend received by petitioner as a stockholder in the West Side Lumber Co. on April 14, 1923, was a "distribution * * * out of * * * earnings or profits accumulated since February 28, 1913 * * *" and

therefore taxable; and how much a distribution out of "earnings or profits accumulated * * * prior to March 1, 1913" and therefore exempt. The case is governed by the Revenue Act of 1921; the applicable provisions are set out in the margin.

Petitioner's case before the Board was consolidated with that of Canfield, another stockholder in the Lumber Co., as to whom the same issue was presented. In so far as the decision affected Canfield, it was reversed in Canfield v. Commissioner, 62 F. (2d) 751 (C. C. A. 7, 1933). For the detailed facts with respect to the corporate financial situation, stipulated there as here, we refer to the statement in that case; pp. 751-52. We restate them briefly (giving round instead of exact figures).

On March 1, 1913, the company had a surplus of $4,400,000. Profits for the year ending February 28, 1914, were $4600. In each of the years ending February 28, 1915 and 1916, losses were suffered, together amounting to $400,000. Each year thereafter up to and including that in which the dividend in controversy was declared, the company made profits totalling in all $2,450,000.

Dividends amounting to $1,290,000 were declared between March 1, 1917, and February 12, 1923. The dividend of April 14, 1923, was in the sum of $5,100,000, of which petitioner, who held 3270 out of 15,000 shares, received $1,111,800.

The corporation has the right, under the statute, petitioner contends, to maintain the capital and earned, as well as paid in surplus that it had on

February 28, 1913, and, if they be impaired by subsequent losses, to restore them out of later profits, thereby leaving only the net profits, if any, of the period after February 28, 1913, as the "earnings or profits accumulated since February 28, 1913."

Respondent, on the other hand, contends that if the corporation instead of maintaining or distributing the earned surplus of February 28, 1913, prefers to risk its impairment by using it in the business, there is no statutory provision for applying subsequent profits to restoring that surplus to its original amount, if, meantime, losses shall have been incurred. If profits are earned after February 28, 1913, subsequent losses, concededly, would be chargeable against them, so far as they go; in this case, to the extent of $4600 earned in the year ending February 28, 1914. The losses, however, in excess of such profits, incurred before further

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"(a) * * * the term 'divided' when used in this title * * * means any distribution made by a corporation to its shareholders or members, * * * out of its earnings or profits accumulated since February 28, 1913, * * *

"(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in

profits are earned, are necessarily, respondent urges, paid out of and chargeable against the February 28, 1913, earned surplus, and are not held in suspense, to be paid out of later possible profits. If then profits are earned after that surplus shall have been so reduced, the entire amount thereof is asserted to be the "earnings or profits accumulated since February 28, 1913," and dividend distributions therefrom to be taxable.

14.91% or 22.75% of the April, 1923, dividends would be taxable as coming from these post February 28, 1913, accumulations, dependent upon which of these contentions is sound.

The Board of Tax Appeals in Walker v. Commissioner, 27 B. T. A. ....., stated to have been formulated before but announced after the Canfield decision in the 7th C. C. A., and later in Garrett v. Commissioner, ... B. T. A. ..... (Mar. 10, 1933), adopted the views expressed by the 7th C. C. A. in the Canfield case.

These decisions, and petitioner's contention, are based, in part, on the view that the Supreme Court has developed a general doctrine that accumulations prior to March 1, 1913, are to be treated as capital for all income tax purposes.[1] Clearly for some income tax purposes such accumulations are so treated. See, Lynch v. Turrish; Southern Pacific

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value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed * * *." 42 Stat. 227.

Co. v. Lowe, both supra, note 1. But, on the day the Turrish and Southern Pacific cases were decided the Supreme Court in Lynch v. Hornby, 247 U. S. 339 (1918), recognized that for other purposes they need not be so treated. As the court said, in the Hornby case:

> "Of course we are dealing here with the ordinary stockholder receiving dividends declared in the ordinary way of business. Lynch v. Turrish and Southern Pacific Co. v. Lowe, rest upon their special facts and are plainly distinguishable." (p. 346.)

Further discussion of the Turrish and Southern Pacific cases, and the later cases, which add little if anything to the picture, will serve no useful purpose. It suffices to say that they establish no such doctrine as that for which petitioner contends.

Solution of the present question is not to be found in a formula thought to be developed in decisions addressed to entirely different situations. It must be sought in the specifically applicable

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[1]Cited as establishing this doctrine are: Old Colony R. R. v. Commissioner, 284 U. S. 552 (1932); Lucas v. Alexander, 279 U. S. 573 (1929); Eisner v. Macomber, 252 U. S. 189 (1920); Gulf Oil Corp. v. Lewellyn, 248 U. S. 71 (1918); Lynch v. Turrish, 247 U. S. 221 (1918); Southern Pacific Co. v. Lowe, 247 U. S. 330 (1918); Meischke-Smith v. Wardell, 286 F. 785 (C. C. A. 9, 1923); United States v. Guinzburg, 278 F. 363 (C. C. A. 2, 1921); Park v. Gilligan, 293 F. 129 (D. C. Ohio, 1921).

statutory provisions. The 1913 Act was held constitutional in providing for the tax on dividends paid out of surplus accumulated prior to March 1, 1913. Lynch v. Hornby, supra. The 1916 Revenue Act exempted such distribution; the court said in Lynch v. Hornby:

> "* * * as a concession to the equity of stockholders * * * in view of constitutional questions that had been raised in this case, in the companion case of Lynch v. Turrish, and perhaps in other cases." (p. 346.)

The later revenue acts have consistently preserved the exemption, even though, constitutionally, such dividends could be taxed.

We are here concerned with the extent of the exemption conferred by the Act of 1921. This act does not expressly convert the February 28, 1913, surplus into capital. It declares only that distributions out of accumulations since February 28, 1913, are taxable, that distributions out of accumulations prior thereto are exempted (see applicable provisions set out in margin, supra). In these provisions, there is no attempt to define capital for the purposes of the act. The statute specifies only that certain accumulations may be and certain others may not be distributed tax free. And the question is: What are included within these terms? We turn, therefore, to the phrase which describes the exemption:

> "* * * any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and

profits since February 28, 1913, have been distributed."

Fairly construed, this is a privilege granted to a corporation to distribute by way of dividends, tax free as to its stockholders, any surplus that it may have on February 28, 1913. If, however, instead of distributing the surplus, the corporation, as in this case, subjects it to the hazards of the business, there is no provision for restoring, out of future normally taxable earnings, any part of the surplus that may thereby have been lost.

Petitioner emphasizes the clause defining taxable dividends instead of the exemption clause. He contends that the taxable "earnings or profits accumulated since February 28, 1913," must be deemed to mean net earnings or profits, that is, only the excess of profits earned over losses incurred after that date, and that therefore any distribution over and above such net profits must be deemed to be paid out of the tax exempt surplus of February 28, 1913. The argument ignores both bookkeeping and reality. The factual situation is that a part of the February 28, 1913, surplus was lost in the business in the following years. The distribution, of course, was not from losses but from the later earnings. Because Congress made distributions from the old surplus tax free, it cannot fairly be deemed to have intended that that surplus may be restored after it shall have been impaired by losses, and, in our judgment, the statutory language, fairly construed, admits of no such interpretation. Any such intent could have been

readily expressed by exempting "an amount equal to the February 28, 1913, surplus" or by taxing "the net profits earned after February 28, 1913."

The Treasury Department officials have consistently interpreted this and similar provisions in accordance with the views herein expressed.[2] While these interpretations do not have the force of Treasury Regulations, it may reasonably be assumed, as respondent urges, that if opposed to the legislative intent, they would have been changed in the 1924, 1926, 1928 or 1932 Acts. Cf. Murphy Oil Co. v. Burnet, 287 U. S. 299, 302-03 (1932), and cases cited; Mass. Mutual Life Ins. Co. v. United States, 288 U. S. 269, 273 (1933). Shorb v. Commissioner, 22 B. T. A. 644, 645, does not indicate, as petitioner contends, that the Treasury Department has been inconsistent. In that case the actual capital was impaired; there was no surplus on February 28, 1913. We express no opinion on such a case.

The decision in Blair v. United States, 63 C. Cls. 193 (1927), certiorari denied, 275 U. S. 546 (1927), appears to support the conclusion that we have reached. In Hadden v. Commissioner, 49 F. (2d) 709 (C. C. A. 2, 1931), there was stated to be a deficit, not a surplus, on March 1, 1913. Certain expressions in the court's opinion, though literally contrary to the views herein expressed, must be

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[2] A. R. M. 82, 3 Cumulative Bulletin 36 (1920); G. C. M. 3532, VII-1, Cumulative Bulletin 190 (1928).

deemed limited to the factual situation as there stated. If, as petitioner urges, a search of the record in other proceedings before the Board of Tax Appeals shows that there was in fact a surplus in the Hadden case, we may say with Judge Learned Hand (The San Simeon, 63 F. (2d) 798, 802 (C. C. A. 2, 1933)) that

> "* * * the practice of searching records and extracting as a part of the decision what the court did not mean to hold, may be useful as an academic exercise, but it is otherwise idle."

In Leland v. Commissioner, 50 F. (2d) 523 (C. C. A. 1, 1931), the surplus was paid in, not earned; the court assumed that such a paid in surplus, if diminished by losses, could be restored out of later profits, in holding that the losses of 1921, the year of incorporation, would be deductible from the profits of the succeeding years, in determining the taxability of a subsequent dividend distribution. There was, of course, on January 1, 1921, no earned surplus from which these losses could have been deducted. Unlike an earned surplus, a paid in surplus is, for these purposes, properly treated like capital.

The chronological order of profit and loss, as a basis for determining taxability, involves no absurdity, as argued by petitioner; it is not infrequently determinative in matters of taxation, as well as in other vital business affairs. An earned surplus on hand at the beginning of the year is subjected to the hazards of the business. If, despite the risk, losses are averted, that surplus has

remained intact and is distributable as a tax-free dividend after the profits, if any, shall have been paid out as taxable dividends. If, however, losses have been incurred, that surplus has been reduced to the extent thereof; it is no longer intact and available for such tax-free distribution.

The well settled practice in income tax matters is a sufficient answer to petitioner's challenge of the yearly instead of a quarterly or monthly basis for the determination of profit and loss. Cf. Burnet v. Sanford & Brooks Co., 282 U. S. 359 (1931).

Affirmed.

[Endorsed]: Opinion. Filed May 19, 1933. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals, for the Ninth Circuit.

No. 6838.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT.

Upon petition to review an order of the United States Board of Tax Appeals, this cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was

duly submitted. On consideration whereof, it is now here ordered and adjudged by this Court, that the order of the said Board of Tax Appeals in this cause be, and hereby is affirmed.

[Endorsed]: Judgment. Filed and entered May 19, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

APPLICATION FOR STAY OF MANDATE.

To the Honorable Curtis D. Wilbur, Presiding Judge, the Honorable William H. Sawtelle, Associate Judge, and the Honorable Francis A. Garrecht, Associate Judge, Judges of the Circuit Court of Appeals for the Ninth Circuit.

Your petitioner respectfully applies to this Honorable Court for a stay of mandate in the above entitled proceeding, and in support thereof and as grounds therefor respectfully alleges:

1. Petitioner purposes to apply to the Supreme Court of the United States for the issuance of a writ of certiorari to review the decision rendered by this court in the above entitled case on May 19, 1933.

2. The above entitled case and the case of Canfield v. Commissioner of Internal Revenue (No. 4761 of the United States Circuit Court for the Seventh Circuit) involve identical issues. The two proceedings were consolidated for hearing before

the United States Board of Tax Appeals and said Board rendered but one decision for the two cases. The United States Circuit Court of Appeals for the Seventh Circuit reversed the decision of the Board in Canfield v. Commissioner; while this Court has affirmed the identical decision of the Board in this proceeding. These adverse decisions cause a direct conflict which can be adjudicated only by the Supreme Court of the United States.

3. Petitioner is informed and believes that the Attorney General of the United States intends to forthwith apply to the Supreme Court of the United States for the issuance of certiorari to review the decision of the Circuit Court of Appeals for the Seventh Circuit in the proceeding entitled Charles J. Canfield v. Commissioner of Internal Revenue (No. 4761 in said Circuit).

4. Unless stay of mandate is granted in this proceeding petitioner will be deprived of any benefit of certiorari which may be granted in Canfield v. Commissioner of Internal Revenue, should the decision in that case by the United States Circuit Court of Appeals for the Seventh Circuit be affirmed by the United States Supreme Court.

It is respectfully submitted that, on the above allegation, stay of mandate should be ordered by this court.

EDWIN H. CASSELS,
ADOLPHUS E. GRAUPNER,
Attorneys for Petitioner.

[Endorsed]: Filed May 25, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

ORDER STAYING ISSUANCE OF MANDATE.

Upon application of Mr. Adolphus E. Graupner, counsel for the petitioner, and good cause therefor appearing, IT IS ORDERED that the issuance, under Rule 32, of the mandate of this Court in the above cause be, and hereby is stayed to and including July 1, 1933; and in the event the petition for a writ of certiorari to be made by the petitioner herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

CURTIS D. WILBUR,
United States Circuit Judge.

Dated, San Francisco, California,
May 25, 1933.

[Endorsed]: Filed May 25, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing ninety-six (96) pages, numbered from and including 1 to and including 96, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the petitioner and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 26th day of May, A. D. 1933.

[Seal] PAUL P. O'BRIEN, Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(4100)

FILE COPY

FILED
JUN 29 19
CHARLES ELMORE

IN THE

Supreme Court of the United States

No. 212

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR THE WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

EDWIN H. CASSELS,
Attorney for Petitioner.

BARRY GILBERT,
ADOLPHUS E. GRAUPNER,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

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IN THE

Supreme Court of the United States

No. .....

WILLIAM R. THORSEN,
Petitioner,

vs

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR THE WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of William R. Thorsen respectfully shows to this Honorable Court:

A.

The Commissioner of Internal Revenue, on March 6, 1928, found a deficiency of $36,720.96 in the income tax for the calendar year 1923 of the petitioner herein, William R. Thorsen, of San Francisco, California. On May 2, 1928, Thorsen filed in the United States Board of Tax Appeals his petition for a review of the finding of the Commissioner.

On November 25, 1927, the Commissioner of Internal Revenue had found a deficiency of $9,243.66 in the income tax for the calendar year 1923 of Charles J. Canfield, of Chicago, Illinois. On Janu-

ary 20, 1928, Canfield had filed in the United States Board of Tax Appeals his petition for a review of such finding of the Commissioner.

Both Thorsen and Canfield were stockholders in West Side Lumber Company and the additional tax in each case was a surtax assessed on account of the receipt by each of his share of a dividend paid by that company in 1923.

The two cases were consolidated for hearing befor the Board of Tax Appeals and heard together as one case.

Thereafter (after a review of a previous divisional opinion) on October 27, 1931, the final decision of the Board in the two cases was promulgated with but one set of findings of fact and one opinion, sustaining (with conceded corrections) the findings of the Commissioner in the two cases, seven of the then fifteen members of the Board dissenting. (*Canfield* v. *Commissioner; Thorsen* v. *Commissioner,* 24 B. T. A. 480.)

Thereafter, on February 1, 1932, Canfield filed his petition for a review of so much of the decision of the Board as affected his tax, by the Circuit Court of Appeals for the Seventh Circuit. That court on January 13, 1933, *reversed* the decision of the Board of Tax Appeals so far as it affected Canfield, the issue (one entirely of law) upon his petition being identical with that presented in the case of Thorsen. (*Canfield* v. *Commissioner,* 62 Fed. (2d) 751.)

On April 16, 1932, Thorsen filed in the Circuit Court of Appeals of the Ninth Circuit his petition for a review of the same decision of the Board as far as it affected his tax.

The Circuit Court of Appeals of the Ninth Cir-

cuit, on May 19, 1933, *affirmed* the decision of the Board of Tax Appeals. Thorsen now files herein his petition for the writ of certiorari to review this decision, which is squarely in conflict with that of the Circuit Court of Appeals of the Seventh Circuit on indentically the same question of law.

In the meantime, in an opinion prepared before the decision of the Circuit Court of Appeals of the Seventh Circuit, the Board of Tax Appeals itself in *Walker* v. *Commissioner,* 24 B. T. A. ...., involving this same point, handed down an opinion contrary to its prior opinion in the Canfield and Thorsen cases and in accord with the decision of the Circuit Court of Appeals of the Seventh Circuit in the Canfield case. The Board, since the decision in the Thorsen case, has refused to reconsider its decision in the Walker case, although Walker is a resident of the Ninth Circuit.

THE ISSUE.

All the facts were stipulated. The only question is one of law.

Canfield and Thorsen were both stockholders in West Side Lumber Company, a corporation, which on March 1, 1913, had a paid-in capital of $1,500,000 and a surplus of $4,332,684.78. Its earnings and losses after that date were:

Year Ending	Profits	Losses
February 28, 1914	$ 4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
March 1, 1923 to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
	$2,455,282.92	$404,846.99

The net of its operations for the period March 1, 1913, to April 14, 1923, was thus $2,050,435.93. During the years 1918 to April 1923, West Side Lumber Company had distributed $1,290,000 of this amount in dividends. The undistributed net balance as of April 14, 1923, from such operations was therefore $760,435.93. On that date, it paid a further dividend of $5,100,000, or $340 per share, to its stock-

holders, among them Canfield and Thorsen. The question is, what portion of this distribution was taxable and what portion was non-taxable under the provisions of Section 201 of the Internal Revenue Act of 1921, which reads as follows:

> "SEC. 201. (a) That the term 'dividend' when used in this title (except in paragraph (10) of subdivision (a) of Section 234 and paragraph (4) of subdivision (a) of Section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made, the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent, that the basis provided in Section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon."

The petitioner contends that the "earnings or profits *accumulated* since February 28, 1913," nec-

essarily mean the *net* earnings or profits of the period from March 1, 1913, to the date of the dividend distribution. The Commissioner does not agree with this interpretation. He contends that the statute contemplates the distribution, first, of the net earnings of the last year of the period, then the earnings of the next to the last year, and so on backward, until losses are encountered in any given year. Then, he considers, such losses are to be applied against earnings of years antedating such losses and, if need be, against the surplus of March 1, 1913.

The net effect of these different interpretations, as applied to the facts of the Canfield and Thorsen cases, is that the Commissioner thus excludes the losses of $404,846.99 from the reckoning, in determining the "earnings accumulated since February 28, 1913," (excepting as they are used to absorb the profit of $4,594.62 for the year ending February 28, 1913), and considers only the accumulated successive profits of the period *March 1, 1916,* to April 14, 1923. The petitioner insists that such losses of $404,846.99 cannot be thus excluded from the reckoning, and that the net "earnings accumulated since February 28, 1913" were $2,050,435.93—of which $760,435.93 was on hand and undistributed on April 14, 1923, and hence was taxable to the stockholders who received it. The Commissioner by his method arrived at the figure of $1,160,658.30 as the undistributed earnings on April 14, 1923, "accumulated since February 28, 1913" and held this amount to be taxable to the several recipients.

Thorsen made his return upon the theory that he was taxable only with respect to his share of the net of operations of West Side Lumber Company from March 1, 1913, to April 14, 1923, as those figures were

given to him at the time he made his return. An audit of its books lessened the amount of such net to such an extent that if his interpretation of Section 201 be correct, he is entitled to a refund. If the Commissioner be right, there is a tax deficiency for 1923 of $27,131.69.

B.

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. The decision of the Court of Appeals of the Ninth Circuit is in direct conflict with the decision of the Circuit Court of Appeals of the Seventh Circuit in the case of *Charles J. Canfield* v. *Commissioner of Internal Revenue* (62 Fed. 2d. 751). It is also in conflict with the decision of the Circuit Court of Appeals of the Second Circuit in the case of *T. Irving Hadden, Executor* v. *Commissioner* (49 Fed. 2d. 709).

2. The Circuit Court of Appeals of the Ninth Circuit has herein decided an important question of federal law which has not been, but should be, settled by this court.

3. The Circuit Court of Appeals of the Ninth Circuit has herein decided a federal question in a way probably in conflict with applicable decisions of this court.

WHEREFORE your petitioner respectfully prays that the writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals of the Ninth Circuit, commanding that court to certify and to send to this

court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, Number 6838, William R. Thorsen, Petitioner, *vs.* Commissioner of Internal Revenue, Respondent, and that the said judgment of the Circuit Court of Appeals for the Ninth Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

WILLIAM R. THORSEN,

EDWIN H. CASSELS,
Attorney for Petitioner.

BARRY GILBERT,
ADOLPHUS E. GRAUPNER,
Of Counsel.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR THE WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion of the Circuit Court of Appeals for the Ninth Circuit was rendered on May 19, 1933. (R. 83.) It has not yet been officially reported. A copy of the opinion is reprinted in the record at page 84. The findings of fact, opinion and decision of the Board of Tax Appeals were filed on October 21, 1931, and are reported in 24 B. T. A. 480.

II.

JURISDICTION.

1. The statutory provision believed to sustain jurisdiction is Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

2. The date of the judgment to be reviewed is May 19, 1933. (R. 83.) No petition for rehearing was filed. An order was entered on May 25, 1933, by the Circuit Court of Appeals of the Ninth Circuit staying the mandate, pending this application. (R. 96.)

3. The nature of the case is stated under the heading "A" in the petition, and therefore is not here repeated.

4. The jurisdiction is believed to be sustained by *Gulf Oil Corporation* v. *Llewellyn,* 248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35; *Old Colony Railroad Company* v. *Commissioner of Internal Revenue,* 284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211; and *Aiken* v. *Burnet,* 282 U. S. 277; 75 L. Ed. 339; 51 S. Ct. 148.

III.

STATEMENT OF THE CASE.

A full statement of the case has been given under the heading "A" in the petition and hence is not here repeated.

IV.

SPECIFICATIONS OF ERRORS.

The errors of the Circuit Court of Appeals for the Ninth Circuit to be urged are:

1. It erred in finding that any deficiency existed with respect to the income taxes of Thorsen for the calendar year 1923.

2. It erred in not finding that Thorsen is entitled to a refund of income taxes overpaid by him for the calendar year 1923.

3. It erred in so interpreting the provisions of Section 201 of the Internal Revenue Act of 1921 that the losses of West Side Lumber Company for the years ending February 28, 1915, and February 29, 1916, were not deducted from its total profits of the years March 1, 1916, to April 23, 1923, in computing its "earnings accumulated since February 28, 1913," within the meaning of such section.

4. It erred in not finding that the words "earnings or profits accumulated since February 28, 1913," in Section 201 of the Internal Revenue Act of 1923 mean the net profits of the whole period from March 1, 1913, to the date of the distribution of profits.

5. It erred in finding that the dividend distribution of West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 14.91 per cent taxable.

V.

ARGUMENT.

A.

Reasons Relied Upon for the Allowance of the Writ.

1. The first reason given in the petition for the allowance of the writ of certiorari is that the decision of the Circuit Court of Appeals in this case is in direct conflict with the decision of the Circuit Court of Appeals of the Second Circuit in the case of *Charles J. Canfield* v. *Commissioner of Internal Revenue* (62 Fed. 2d. 751), and with the opinion and decision of the Circuit Court of Appeals of the Second Circuit in the case of *T. Irving Hadden, Executor,* v. *Commissioner of Internal Revenue* (49 Fed. 2d. 709).

The conflict with the Canfield case is direct and positive. Both cases grew out of the dividend distribution of West Side Lumber Company on April 14, 1923, of $5,100,000. Canfield had 600 shares of stock in that company and received $204,000 of that distribution. Thorsen had 3,270 shares and received $1,111,800. The Commissioner sought to assess deficiencies in each case on the theory that the losses of West Side Lumber Company for the years ending February 28, 1915 ($193,139.67) and February 29, 1916 ($211,707.32) should not be deducted from its aggregate profits of the years from March 1, 1916, to April 14, 1923, in determining the taxable proportion of such distribution, and that they should, instead, be regarded as a dissipation of the surplus of that company of March 1, 1913.

There is absolutely no difference whatever in the two cases beyond the difference in the number of shares owned by the two men and hence in the number of dollars received by each in the distribution. One happens to live in the Seventh Circuit and one in the Ninth Circuit. The Canfield half of the decision of the Board of Tax Appeals has been reversed and the Thorsen half affirmed. One or the other court is of necessity wrong.

The Commissioner has filed in this court his petition for certiorari in the Canfield case. Both cases therefore are here pending upon identical applications.

Not alone is there this conflict with the Canfield case, but the present decision likewise conflicts with the decision of the Circuit Court of Appeals of the Second Circuit in the Hadden case. The court in that case had under consideration the corresponding section of the Act of 1916, construed it and announced the following principle:

> "The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates."

This is the principle for which Thorsen here contends. The Hadden case is, we submit, a direct decision on the question at issue herein and is adverse to that of the Circuit Court of Appeals of the Ninth Circuit. It therefore appears that the present decision is in conflict with decisions in the Second and the Ninth Circuits. Without question, it is in square conflict with the decision of the Circuit Court of Appeals of the Seventh Circuit in the Canfield case.

2. The second reason relied upon for granting

certiorari is that the present case decides an important question of federal law which has not been, but should be, settled by this court.

Paragraph (a) of Section 201 of the 1921 Act first appeared (in substantially the same form) as Section 2 (a) of the 1916 Act. Paragraph (b) first appeared, (in somewhat different form) as Section 31 (c) of the Act of 1917. The two were combined in the Act of 1918 as Section 201 and have been reenacted in the 1921, 1924, 1926, 1928 and 1932 Acts (with certain amendments from time to time to meet certain other changes in the various acts).

The issue in this case can readily arise under all these acts and has repeatedly arisen, as is shown by the Hadden, Canfield, Thorsen and Walker cases. That a large number of similar cases are pending before the Bureau of Internal Revenue is asserted in the petition of the Commissioner for certiorari in the Canfield case.

The Board of Tax Appeals having now held definitely against the contention of the Commissioner, it would appear that confusion must persist upon this question until this court has settled it. Apparently, the Commissioner will continue to assess deficiencies upon his theory. Upon appeal, the Board of Tax Appeals will, it would seem, continue to hold adversely to the Commissioner, who will therefore be driven to proceedings to review such decisions of the Board in the several circuits. This case therefore involves an unusually important question of federal law which has not been, but should be, decided by this court.

3. The third reason relied upon is that the Circuit Court of Appeals has herein decided a federal

question in a way probably in conflict with applicable decisions of this court.

In *Southern Pacific Co.* v. *Lowe* (247 U. S. 330; 62 L. Ed. 1142; 38 S. Ct. 540) Mr. Justice Pitney said:

> "This being so, we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being *capital, not income, for the purposes of the act.*" (Italics supplied.)

Statements and decisions of like or similar character have been made by this court in *Gulf Oil Corporation* v. *Lewellyn* (248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35), *Eisner* v. *Macomber* (252 U. S. 189; 64 L. Ed. 521; 40 S. Ct. 189), *Lucas* v. *Alexander* (279 U. S. 573; 73 L. Ed. 851; 49 S. Ct. 426) and *Old Colony Railroad Company* v. *Commissioner*, (284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211).

It has been urged in the present case and the other pending cases that under these decisions a corporate surplus of March 1, 1913, has been made capital by the several acts, with the ordinary attributes of capital. Treasury rulings admit that when original capital is depleted it may be replaced from later earnings and then distributed tax-free to the recipient. The Commissioner denies the right of replacement as to such of the capital of March 1, 1913, as was not paid-in capital. There appears to be no basis for such different treatment of earned capital (as of March 1, 1913) and original paid-in capital. Hence, the Circuit Court of the Ninth Circuit, having denied the attributes of capital to the surplus of March 1, 1913, has decided a federal question in a way probably in conflict with applicable decisions of this court.

B.

The Point Involved.

The question involved in this case is the interpretation of that portion of Section 201 (a) of the Revenue Act of 1921 providing for the taxation of dividends and taxing "any distribution made by a corporation to its shareholders or members * * * out of its earnings or profits accumulated since February 28, 1913." Dividends would not be taxable unless Congress made them so. This provision, defining what dividends only should be taxed, namely, those declared out of "earnings or profits accumulated since February 28, 1913," is the only authority for taxing dividends at all. After such earnings and profits have been distributed, the earnings and profits accumulated prior to March 1, 1913, may be distributed tax free.

It is the position of the petitioner that:

(1) The date of March 1, 1913, was the ending of one period and the beginning of another,* and that the two are wholly distinct, each with its own surplus or deficit as the case may be;

(2) The tax is levied only upon the profits accumulated in a specified period, *as such,* and hence *the entire period,* and not the several years composing the period, is the unit of computation;

(3) This being so, to arrive at the taxable accumulations of the period, the aggregate of all losses of the several loss years of the period must be sub-

*In *Lucas* v. *Alexander,* 279 U. S. 573, 73 L. Ed. 851; 49 S. Ct. 426, this court spoke of the "periods before and after March 1, 1913."

tracted from the aggregate of all profits of the several profit years of the period. The difference is the net earnings or profits of the period, and this alone is made taxable on distribution, by the Act of 1921—otherwise, in effect, the words "profits accumulated since February 28, 1921" are stricken from the act.

(4) This mode of computation leaves, of necessity, the surplus of March 1, 1913, intact, and it may then be distributed tax free;

(5) The foregoing approach to the problem exactly co-ordinates with the result arrived at by considering the nature of the surplus of the first period;

(6) This court has repeatedly* spoken of the surplus of March 1, 1913, as "capital for the purposes of the Act." Capital is not taxable upon distribution. If it be temporarily impaired, it may always be replaced from subsequent earnings. Upon replacement, it is then distributable, as before, tax free. This mode of approach arrives at the same result as that reached by interpreting the words "accumulated since February 28, 1913"—that the only taxable distribution is that of the net of the second period;

(7) The Act of 1921 therefore taxed to the recipient Thorsen only his share of the net of the period "since February 28, 1913," and left inviolate for distribution to him his share of the surplus of March 1, 1913—made *"capital, not income, for the purposes of the act."*

**Southern Pacific Co* v. *Lowe*, 247 U. S. 330, 62 L. Ed. 1142, 38 S. Ct. 540; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, 63 L. Ed. 133, 39 S. Ct. 35; *Lucas* v. *Alexander*, 279 U. S. 573, 73 L. Ed. 851, 49 S. Ct. 426; *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, 76 L. Ed. 484, 52 S. Ct. 211.

C.

The Opinion in the Thorsen Case in the Circuit Court of Appeals of the Ninth Circuit.

1. The court below said (R. 89):

> "We are here concerned with the extent of the exemption conferred by the Act of 1921."

It several times refers to the right to distribute the March 1, 1913, surplus, tax free, as an "exemption." In so doing, it adopts the language of the Commissioner, who claimed that there was a burden upon the petitioner to bring himself within an exempting clause. Clearly this is an erroneous approach to the problem.

No tax can be levied without legislative authority. There is no authority anywhere in the act to tax any dividend, excepting the authority contained in paragraph (a). This is strictly a paragraph of *definition,* and not of exemption. It defines the only kind of dividend taxable under the act, namely, one paid out of "earnings or profits accumulated since February 28, 1913." The burden must be on the Commissioner to show that the distribution here sought to be taxed is a dividend paid "out of earnings or profits accumulated since February 28, 1913," for this is the only kind of dividend he can reach. All others are simply untaxed and the burden is on him to show his authority to tax. No such authority will be presumed. This erroneous position of the court has colored its entire opinion.

2. The court (R. 90) makes the statement that Thorsen's position "ignores both bookkeeping and reality." To the contrary, proper accounting procedure would call for the development of a separate

profit and loss account for the period beginning March 1, 1913, inasmuch as the accumulations of that period are taxable and the accumulations of the prior period are distributable tax free, and have become "capital for the purposes of the act."

Nor does the argument of Thorsen "ignore reality." There is nothing in the record to show that West Side Lumber Company could in fact have distributed instanter $4,332,684.78 of its total assets of $5,833,684.78. This would have required a 74 per cent liquid position—one scarcely to be anticipated for any corporation, and in particular not for a lumber company, with its capital necessarily largely invested in fixed assets. It would be an unreasonable interpretation to require instant liquidation in order to take advantage of the tax-free provision, for Congress did not anticipate the liquidation, but the continuance of corporate enterprises.

This is the more obvious from the fact that the Act *in 1921* provided that the *March 1, 1913,* surplus might *then* be distributed tax free. Why should temporary fluctuations in position in 1915 and 1916 be deemed to have been important, when Congress in 1921 recognized the whole March 1, 1913, surplus, after the lapse of eight years, to be *then* distributable without tax? Thorsen's position accords with reality and the opinion of the lower court ignores it.

3. The court expresses the view that March 1, 1913, surplus must be deemed hazarded in the business and forever dissipated if temporarily drawn on, because there is no express provision in the act for its replacement. There is no express provision in the act for the replacement of paid-in capital, but even the court below recognizes that paid-in capital, though also hazarded and drawn on, may be re-

placed. No express provision is necessary. If, as this court has said, March 1, 1913, surplus is "capital *for the purposes of the act,*" it has, it would seem, this attribute of capital in questions arising under the act. There is no reason why it should be differentiated from paid-in capital for the purposes of the act. The fact that in the year 1921 Congress specifically said that the surplus of *March 1, 1913,* was *then* distributable tax free, confirms the view that the tax-free distribution is a constant and not a variable. Indeed, all the acts, including that of 1932, continue to recognize March 1, 1913, surplus, as such, and even to-day give the right to distribute it tax free.

4. The court below omits discussion of the heart of the case, namely, the words *"profits accumulated since February 28, 1913."* Without reference to the question of capital replacement, these words require the conclusions urged by the petitioner. Whether losses of 1915 and 1916 shall be charged against surplus or entered as deficit items in a new profit and loss account, is a matter merely of bookkeeping. Conclusions should not flow out of mere matters of accountancy. It is the act that is to be interpreted. The plan of Congress would seem self-evident, namely, to create two independent periods (1) that antedating income taxation and (2) that subject to such taxation. Whatever had been earned was to be distributed free from tax; that which was to be earned was to be taxed on distribution. The net of the first period was to be free from tax and the net of the second period was to be taxed. The case is as simple as that. Any other view flows out of a bookkeeping concept of the statute. The court below failed to discuss the intent of Congress and

the meaning of the clause, *"accumulated since February 28, 1913."*

The petitioner therefore prays that the writ of certiorari may issue to the Circuit Court of Appeals of the Ninth Circuit to review its decision herein.

EDWIN H. CASSELS,
Attorney for Petitioner.

BARRY GILBERT,
ADOLPHUS E. GRAUPNER,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1933.

No. 212

WILLIAM R. THORSEN,

Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF IN BEHALF OF PETITIONER, WILLIAM R. THORSEN.

EDWIN H. CASSELS,
Attorney for Petitioner.

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SUMMARY OF ARGUMENT:

1.

The taxable portion of the dividend is the difference between the total income and the total outgo for the entire period from February 28, 1913, to the date of the dividend 9

2.

The surplus of March 1, 1913, having been accumulated before that date, is not subject to diminution by subsequent operations and, being tax-free, is treated by the Revenue Act of 1921 (and former acts, beginning with the Act of 1916) precisely as if it were capital 23

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BRIEF IN BEHALF OF PETITIONER, WILLIAM R. THORSEN.

I.

Official Reports of the Opinions Delivered Below.

The opinion of the Circuit Court of Appeals for the Ninth Circuit in this case is found in 65 Fed. (2d) 234. The Findings of Fact, Opinion and De-

cision of the Board of Tax Appeals, (Trans., 54-65) are reported in 24 B. T. A. 480. The opinion of the Circuit Court of Appeals for the Seventh Circuit in the companion case of *Canfield* v. *Commissioner* is reported in 62 Fed. (2d) 751.

II.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 19, 1933. (Trans., 93.) The petition for a writ of certiorari was filed on June 29, 1933, and was granted on October 9, 1933. The jurisdiction of this court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

III.

Statement of the Case.

The Commissioner of Internal Revenue on March 6, 1928, found a deficiency of $36,720.96 in the income tax for the calendar year 1923 of William R. Thorsen, a resident of San Francisco, California. On November 25, 1927, he had likewise found a deficiency of $9,243.66 in the income tax for the same year of Charles J. Canfield, a resident of Chicago, Illinois. Each taxpayer thereafter filed his petition in the United States Board of Tax Appeals for a review of the finding in his case. These appeals were there consolidated for hearing and the Board, by a vote of 8 to 7, in a single opinion, sustained the findings of the Commissioner. A dissenting opinion was also filed. The Board recomputed the deficiency under its Rule 50 and found the amount to be $27,131.69.

Both Thorsen and Canfield were stockholders in West Side Lumber Company, a California corporation, and the additional tax in each case was a surtax assessed solely on account of the receipt by each of his share of a dividend paid by that company on April 14, 1923.

After the decision by the Board, Canfield perfected his appeal to the United States Circuit Court of Appeals for the Seventh Circuit, and that court on January 13, 1933, *reversed* the decision of the Board so far as it affected him.* Meanwhile, Thorsen perfected his appeal to the United States Circuit Court of Appeals for the Ninth Circuit, which on May 19, 1933, upon identical facts and upon the same issues of law, *affirmed* the decision of the Board of Tax Appeals so far as it affected Thorsen. The Commissioner then filed his petition here for certiorari in the Canfield case and Thorsen filed a similar petition in his case. This Court on October 9, 1933, granted both petitions.

All the facts were stipulated and are substantially

* The Board of Tax Appeals, in *Walker* v. *Commissioner*, 27 B. T. A. 829, in an opinion therein stated to have been prepared before (but which was announced after) the Canfield decision in the Circuit Court of Appeals for the Seventh Circuit, squarely reversed its previous position and adopted the views asserted by Canfield and Thorsen. After the decision of the Circuit Court of Appeals of the Ninth Circuit in the Thorsen case, the Board refused to reconsider the Walker case, although Walker is a resident of the Ninth Circuit. It adhered to its decision in the Walker case in *Bouton; Garrett et al.* v. *Commissioner*, Mem. Op. March 10, 1933. Thus, the present view of the Board, the view of the Circuit Court of Appeals for the Second Circuit in *Hadden* v. *Commissioner*, 49 Fed. (2d) 709, and that of the Circuit Court of Appeals for the Seventh Circuit, all accept the theory of Thorsen. The only opposing decision is the one of the Ninth Circuit here under review. In the *Hadden* case, the Court said:

> "The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates."

While the Commissioner calls this statement dictum, a full understanding of the *Hadden* case shows that the company there involved had an actual surplus on March 1, 1913, and hence that the above statement was decision and not dictum.

identical in the two cases. The facts in this case will be found at pages 38 to 49 of the Transcript. From these it appears that:

During the period from March 1, 1913, to and including April 14, 1923, the capital stock of West Side Lumber Company, a California corporation, of San Francisco, California, consisted of 15,000 shares of the par value of $100 each. Thorsen owned 3,270 and Canfield 600 of such shares during all of such period. On March 1, 1913, West Side Lumber Company had its original capital of $1,500,000 and also a surplus of $4,332,684.78. On April 14, 1923, its surplus was $5,093,120.71, or an increase of $760,435.93 over the surplus of March 1, 1913.

The profits and losses of the company after March 1, 1913, were as follows:

Year Ending	Profits	Losses
February 28, 1914...	$ 4,594.62	
February 28, 1915...		$193,139.67
February 29, 1916...		211,707.32
February 28, 1917...	60,495.56	
February 28, 1918...	57,901.55	
February 28, 1919...	208,737.34	
February 29, 1920...	543,490.33	
February 28, 1921...	640,837.43	
February 28, 1922...	182,954.63	
February 28, 1923...	718,858.29	
March 1, 1923 to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
	$2,455,282.92	$404,846.99

The difference between the above totals is $2,050,435.93. During the years 1918 to April 1923, West Side Lumber Company had distributed $1,290,000 of

this amount in dividends. (Trans., 45.) The remaining undistributed net balance arising out of March 1, 1913, to April 14, 1923, operations was, therefore, as of April 14, 1923, $760,435.93.

On that date, the Company paid a dividend of $5,100,000, of which Thorsen received $1,111,800 on his 3,270 shares. The difference between the parties is as to what part of this $5,100,000 was "accumulated" by West Side Lumber Company "since February 28, 1913," and therefore taxable to the recipient by the provisions of Section 201 (a) of the Internal Revenue Act of 1921. The taxpayer asserts that the above net of operations of that period, or $760,435.93 (being 14.91 per cent of the dividend) constituted such accumulations.* The Commissioner, however, insists upon the sum of $1,160,658.30 (being 22.75 per cent of the dividend) as the sum thus accumulated. He arrives at this figure by omitting entirely from his computation the operations of the Company from March 1, 1913, to February 29, 1916. The exact issue is as to whether he may properly do this.

---

*Thorsen originally returned 16.35 per cent of the dividend received by him, or $181,812, as taxable. This difference between 16.35 per cent and the later and correct figure of 14.91 per cent was due to certain errors in the original income tax return of West Side Lumber Company, which were later corrected by the Commissioner. Thorsen in making his return followed the figures in the Company return. Therefore, if the percentage of 14.91 be correct, he is entitled herein to a refund, as he should have reported $165,769.38 instead of $181,812 as taxable. (He also reported a dividend of $32,700 received by him on February 12, 1923, about which no question is raised). Because the recomputations of the Commissioner in his review of the return of West Side Lumber Company lowered its net income, $6,879.29 of the dividend of April 14, 1923, made before that review, was in fact paid out of paid-in capital. The Commissioner's figures (Trans., 43-45) contain three small arithmetical mistakes ($4,337,289.40 instead of $4,337,279.40; $208,707.34 for $208,737.34; and $37,418.17 for $37,413.17) which give an incorrect total of $2,450,658.30 instead of $2,450,688.30, the correct total. These matters account for the discrepancy between the Commissioner's figures $3,932,442.41 and $3,939,341.70 on pages 43 and 45 of the Transcript.

The case is governed by Section 201 of the Act of 1921 which reads as follows:

"(a) That *the term 'dividend'* when used in this title (except in paragraph (10) of subdivision (a) of Section 234 and paragraph (4) of subdivision (a) of Section 245) *means any distribution made by a corporation* to its shareholders or members, whether in cash or in other property, *out of its earnings or profits accumulated since February 28, 1913,* except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits to the extent of such earnings or profits accumulated since February 28, 1913; but *any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.* If any such tax-free distribution has been made, the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that the basis provided in Section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon." (Italics supplied by us.)

IV.

Specification of Errors Intended to Be Urged.

The petitioner intends to urge all the errors that are specified on page 11 of the petition for certiorari filed by him, namely:

1. The Circuit Court of Appeals of the Ninth Circuit erred in finding that any deficiency existed with respect to the income taxes of Thorsen for the calendar year 1923.

2. It erred in not finding that Thorsen is entitled to a refund of income taxes overpaid by him for the calendar year 1923.

3. It erred in so interpreting the provisions of Section 201 of the Internal Revenue Act of 1921 that the losses of West Side Lumber Company for the years ending February 28, 1915, and February 29, 1916, were not deducted from its total profits of the years March 1, 1916, to April 23, 1923, in computing its "earnings accumulated since February 28, 1913," within the meaning of such section.

4. It erred in not finding that the words "earnings or profits accumulated since February 28, 1913," in Section 201 of the Internal Revenue Act of 1921 mean the net profits of the whole period from March 1, 1913, to the date of the distribution of profits.

5. It erred in finding that the dividend distribution of West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 14.91 per cent taxable.

V.

Summary of Argument.

1. The Revenue Act of 1921 (Section 201) provides that dividends "accumulated since February 28, 1913," only are taxable. To ascertain what is accumulated by a corporation, one must take the time after February 28, 1913, to the day of the date of the dividend, as one single period (entire and undivided); and the amount accumulated (and hence taxable) is the difference between the total income and the total outgo for the period. Likewise, the time before March 1, 1913, must be taken as a single period; and the amount accumulated prior to that date may be distributed tax-free after the amount accumulated since that date has been distributed. The amount accumulated prior to March 1, 1913, must be the surplus as of that date—a fixed and definite amount which, for income tax purposes, may not be increased or diminished by the operations of subsequent years.

2. If the Act is thus properly interpreted, it must necessarily follow that the surplus of a corporation for the purposes of levying taxes under the act should be treated precisely the same as capital.

3. The Circuit Court of Appeals of the Seventh Circuit rightly interpreted the act and applied it to the facts. The Circuit Court of Appeals of the Ninth Circuit at the threshold of its consideration of the case, erroneously made and stressed the point that a question of exemption from tax was involved; whereas the real question is what is, rather than what is not, to be taxed. In arriving at an interpretation of the section in question, it did not give due consider-

ation to the first paragraph of Section 201, which provides that dividends from earnings or profits accumulated since February 28, 1913, only, are taxable. Likewise its judgment was colored by an erroneous view of the bookkeeping aspects of the case, and it improperly gave consideration to the course of interpretation of the statute by the Treasury Department itself. Thus finally it came to an unsound conclusion directly in conflict with that of the Circuit Court of Appeals for the Seventh Circuit.

VI.

Argument.

1.

THE TAXABLE PORTION OF THE DIVIDEND IS THE DIFFERENCE BETWEEN THE TOTAL INCOME AND THE TOTAL OUTGO FOR THE ENTIRE PERIOD FROM FEBRUARY 28, 1913, TO THE DATE OF THE DIVIDEND.

The real question in this case is the application of paragraph (a) of Section 201 of the Revenue Act of 1921 to the stipulated facts. The Commissioner is seeking to tax a dividend received by the taxpayer. Admittedly a part of the dividend is taxable—that part which consisted of the earnings or profits of the corporation "accumulated since February 28, 1913."

The Commissioner asserts that 22.75 per cent and the taxpayer answers that 14.91 per cent of the dividend is taxable. Each claims that the stated percentage measures the amount of the dividend accumulated since February 28, 1913; and both admit that the portion of the dividend representing accumulations "prior to March 1, 1913," is free from tax.

The inquiry, therefore, is to find what part was "accumulated since February 28, 1913." This is taxable. The balance is not taxed.

Hence, the point in controversy is the meaning of the words "accumulated since February 28, 1913." Do these words mean the difference between the aggregate of profits and the aggregate of losses, that is to say, the net increase in assets for the period? If they do, the taxpayer is right. Or, do they mean that under the facts here presented, the operations for the year ending February 28, 1914, and the losses for the years ending February 28, 1915, and February 29, 1916, shall be disregarded in computing the amount "accumulated since February 28, 1913" and that the amount so arrived at shall be deemed to be the aggregate of the profits from the year beginning March 1, 1913, to the date of the payment of the dividend? If they do, the Commissioner is right.

Thus we have simply a question of the interpretation of a section of a tax law. This Court has held that tax laws are not to be interpreted so as "to extend their provisions, by implication, beyond the clear import of the language used or to enlarge their operations so as to embrace matters not specifically pointed out." "In case of doubt they are construed most strongly against the Government, and in favor of the citizen."* A tax law, therefore, must point out what is to be taxed, in clear and unmistakable terms.

Section 213 of the Revenue Act of 1921 provided that "dividends" shall be taxed. There were in that section no words of definition. That function is per-

Gould v. *Gould*, 245 U. S. 151; 62 L. Ed. 211; 38 S. Ct. 53. *Burnet* v. *Niagara Falls Brewing Company*, 282 U. S. 648; 75 L. Ed. 594; 51 S. Ct. 262.

formed by Section 201 (a). This section (here to be interpreted) defined and limited the words "dividends" to "any distribution made by a corporation to its shareholders * * * out of its earnings or profits accumulated since February 28, 1913" (etc.). Thus, obviously, the only dividend that is taxed at all by the act is one (a) that is out of earnings or profits (b) that have been "accumulated" since February 28, 1913.

The opinion below in the Thorsen case erroneously says (Trans., 89):

> "We are here concerned with the extent of the exemption conferred by the Act of 1921."

This fundamental error greatly influenced the whole of the opinion and the decision of the court. Section 201 (a) creates no exemption.* There is no negation or exception in its terms or meaning. It is wholly affirmative and definitive. It specifies the sole and only kind of dividend that *is* taxed, namely, one from earnings and profits accumulated after February 28, 1913. All others are simply not taxed.

The chief reason advanced by the Commissioner and the court below for stressing the point that a question of exemption is involved in this case, seems to lie in the fact that Congress had taxed all dividends, (other than those distributing paid-in capital) by a prior Act—that of 1913. But clearly Congress either had changed its mind or had not expressed in that act its real purpose—*i. e.*, to draw a sharp line, on March 1, 1913, between the accumulations of the

---

* It is in marked contrast with the treatment accorded real exemptions under Section 213, (b), which, after a definition of "gross income" under 213 (a), reads: "Does not include the following items, *which shall be exempt from taxation under this title.*" Then follow twelve paragraphs enumerating such exemptions.

period before the Sixteenth Amendment and the accumulations of the period thereafter, for, before the final interpretation of the 1913 Act by this court, it forthwith in 1916 changed the rule of the 1913 Act.

The term "dividends" in the 1913 Act meant all dividends irrespective of the period of accumulation, and, hence, included two things, (1) a payment from accumulations before March 1, 1913, and (2) a payment from accumulations after that date. The 1916 Act defined the term as meaning only one of these two. It cannot properly be said that this was exempting the former thing from the rule applying only to the latter. They were co-equal situations and the new act simply imposed a tax on one class and not on the other. It is as if dividends were a genus with two distinct separate species, and Congress decreed that only one species should be taxed.

The prior state of the law is unimportant excepting as a background. The 1913 Act was not amended by the 1916 or 1921 Acts. Both were entirely new Acts. The 1913 Act ceased to be a taxing act for later distributions with the advent of the Act of 1916. The new act selected one thing to be taxed, and one only, and named it. Whether Congress was rectifying a mistake or had changed its mind in eliminating for the future the rule yet-to-be-announced (nearly two years later) of *Lynch* v. *Hornby**, it was not creating an exception to a rule;—it was making a *new* rule to change the subject of taxation and to remedy the situation created by the Commissioner in claiming that all dividends were taxable under the 1913 Act. Thus, we are entitled to that liberality of construction which always accompanies a remedial statute, instead of being catalogued as the recipient of an ex-

*247 U. S. 339; 62 L. Ed. 1149; 38 S. Ct. 543.

emption from a tax which had ceased to be with the end of the 1913 Act.

The word "exempt" found in paragraph (b) is unimportant—particularly in interpreting paragraph (a). Paragraph (b) is not the taxing part of the act. Paragraph (a) fixes the tax. Paragraph (b) is a supplemental and subordinate part of the section. The history of this paragraph demonstrates that the provisions therein chiefly relied upon by the Commissioner were enacted solely with reference to differences in rates as between the several years after March 1, 1913. It has performed no function whatever in fixing the taxable and non-taxable parts of a distribution as between the years before and the years after March 1, 1913. It concerns these periods only in two respects: (1) it reiterates, out of caution, merely, the inviolability of earnings accumulated prior to March 1, 1913, and (2) requires the taxable accumulations of the *post*-1913 period to be distributed ahead of the tax-free accumulations of the *ante*-1913 era. The word "exempt" is there used wholly in the sense of *tax-free*. The only part of Section 201 that imposes, or limits or defines any tax is paragraph (a), which appeared first in the 1916 Act. To it alone we must look to find the incidence and character of the tax. Paragraph (b) was not in the 1916 Act. It appeared first in the 1917 Act when it was inserted primarily to meet the situation arising because of the war rates imposed by that act.

These matters would not be of importance were it not for the claim of the Commissioner, and the apparent view of the Circuit Court of Appeals of the Ninth Circuit, that somehow some variety or other of burden is thrown upon the taxpayer, rather than upon the Commissioner, in approaching the inter-

pretation of Section 201 (a). As we conceive it, the proper interpretation of a statute is not a matter involving either presumptions or burdens. It is a search for the intent of the lawmakers. We are not here concerned with any question of fact, but only with the legal meaning of certain words, and the court approaches this task without presumptions of any kind. No tax can be levied without specific legislative authority therefor. The extent of the power of the taxing body is only that fixed by the statute. In that sense, therefore, there is a burden upon the Commissioner to demonstrate that the language employed by Congress justifies the tax here asserted by him. The only power to tax a dividend given to him by the act is that of taxing a specific variety of dividend, one declared out of earnings or profits *"accumulated since February 28, 1913."* No other dividend distribution is taxed. He must therefore demonstrate that the portion of the dividend of April 14, 1923, which he seeks to tax was "accumulated since February 28, 1913," within the meaning of Section 201 (a).

March 1, 1913, is an epochal date in Federal income tax legislation. The Sixteenth Amendment became a part of the Constitution on February 25, 1913. The income tax act of 1913 was enacted on October 3, 1913, and was made expressly retroactive to March 1, 1913. This date, rather than February 25, 1913, was chosen by Congress purely for convenience, but in substance it marks the time when Congress could constitutionally lay a non-apportioned income tax. It is therefore a definite point of departure and whenever used, is deeply significant.

This date is made the dividing point in Section 201 (a) of the 1921 Act. The plan of Congress in this respect would seem to be self-evident, namely, to create two wholly independent *periods,* the first embracing all time antedating income taxation (the income of which is *not* taxed) and the second embracing all time beginning with income taxation down to the date of any given dividend payment,* (the income of which *is* taxed on distribution). This conception of *two entire periods* is fundamental in interpreting this section. The period, as such, is obviously the unit for determining "earnings and profits accumulated *prior* to March 1, 1913." In exactly the same way, the *period* beginning March 1, 1913, and ending April 14, 1923, *as such,* and not the separate component years thereof, is the unit for determining the earnings and profits "accumulated *since* February 28, 1913."

The earnings and profits accumulated in any given *period* are necessarily the net of *all* operations during the period. The Commissioner, however, in this case in attempting to compute the amount "accumulated" by West Side Lumber Company "since February 28, 1913," entirely excludes from the reckoning all the operations of that company from February 28, 1913, to March 1, 1916. He has taken the *several years of the period* as separate units of accumulation, and excludes the first three for reasons which he deems sufficient. The taxpayer's mode of computation, to the contrary, adopts the whole period, as a period, as the unit and excludes from the reckoning none of the company operations between February 28, 1913, and April 14, 1923. If Congress

*In *Lucas* v. *Alexander*, 279 U. S. 573, 73 L. Ed. 851, 49 S. Ct. 426, this Court spoke of the two "periods before and after March 1, 1913."

intended accumulations to be computed by the period, our result is necessarily correct.

The Statute splits the two periods of accumulation on the date of March 1, 1913. The Commissioner by his mode of computation does not do this. He has in effect, *three* periods, (1) that prior to March 1, 1913, (2) then a net loss period from March 1, 1913, to February 29, 1916, and (3) a final "accumulation" period from March 1, 1916, to April 14, 1923. (Trans., 43-45.) His first period accepts the admitted surplus of March 1, 1913, of $4,332,684.78. His second period shows a net operating loss over three years, which results in a surplus of $3,932,442.41 as of February 29, 1916. This figure never again appears in his computations and therefore might just as well never have been arrived at. It is merely laid on the shelf. It does not in any way connect up with any figures used in the third period.

His real computation is that of the third period. It starts with the caption, "*Subsequent earnings*"—that is, *subsequent to February 29, 1916.* These are listed year by year from that date to April 14, 1923, and then totalled. This figure ($2,430,658.30) he calls, "Total earnings March 1, 1916, to April 14, 1923", which is exactly what it is. Thus, the "total earnings March 1, 1916, to April 14, 1923" are to him the "earnings and profits accumulated *since February 28, 1913.*" He has thus wholly ignored in his result the entire time from March 1, 1913, to March 1, 1916, which, however, is a portion of the period "since February 28, 1913" fixed by the statute.

This he justifies upon the ground that the net losses of the time from March 1, 1913, to March 1,

1916, must be charged against March 1, 1913, surplus and that such surplus is thereby to that extent forever dissipated. We submit that he has not interpreted Section 201 (a), but has merely adopted a method of bookkeeping and made the statute conform thereto. Had any year between March 1, 1916 and April 14, 1923, shown a loss, he would have deducted that from the aggregate of profits in the other years between those dates; but he wholly excludes the losses of the two years from March 1, 1914, to March 1, 1916,—solely because of the accident that they came before a surplus had been built up from operations after February 28, 1913.

The answer to the bookkeeping question which the Commissioner faced is very simple. His mode of bookkeeping, if it could be substituted for an interpretation of the simple language of Section 201 (a), is itself incorrect. The statute creates two periods of accumulation and hence contemplates two surplus accounts, one for each of the two accumulation periods. The surplus of the second period, if any, is taxable on distribution. The surplus of the first period is not so taxed. On April 14, 1923, a surplus account for the second period would show $760,435.93, and not $1,160,658.30, as claimed by the Commissioner. It is not important that initially it would show a loss. We are concerned here only with how it stood on April 14, 1923.

A careful study of the act and of the nature of the tax on dividends demonstrates that Congress intended to create one entire period for determining accumulations after February 28, 1913, and not a succession of yearly periods. There is nothing whatever in the language of Section 201 (a) expressly referring to any yearly rest. The tax is laid on distri-

butions out of earnings or profits accumulated "since February 28, 1913," and these words do not naturally imply successive yearly periods, but do imply *one* period only, whether it be longer or shorter than, or equal to, a year.

The tax upon a dividend distribution to the stockholder is very different from the annual income tax upon the corporation which declares the dividend. The latter tax is upon the corporate income accumulated during the year preceding its return. The former, while taxed to the stockholder in the year in which he receives it, is often paid from earnings of prior years. This is particularly so of the liquidating type of dividend here involved. This tax looks behind the recipient to the source of the dividend to ascertain its taxability upon distribution. There is nothing about that source that rests upon the year as such. A dividend is a distribution from a storehouse filled through the aggregate operations antecedent to the date of the dividend, which rarely coincide with those of a mere year. The 1917 Act did not tax the recipient at the rates payable in the year the dividend was received, but at the rates prescribed for the years in which the profits had been accumulated (Act of 1917, Sec. 31, b). The tax here involved is not a normal tax, but a surtax. In short, the tax imposed upon dividends involves many considerations not found in the ordinary tax upon other types of income. The year has slight relation to the theory of taxing corporate distributions of income. Thus, there is nothing in the fact that income tax returns are made annually or that some taxes are based on annual earnings, that creates any inference whatever that the year was in the mind of Congress as a unit of computation in the very different situation here

presented. Instead, Congress here created a second period, as such, for the computation of accumulations "since February 28, 1913," and in consequence every year's operations—indeed every single operation of every year of that period—must be included in the computation. The Commissioner's method offends this principle in that no transaction of West Side Lumber Company from March 1, 1913, to March 1, 1916, is in any way reflected in the Commissioner's result. To the contrary, every item, whether of profit or loss, for the entire time "since February 28, 1913" should and does enter into the computation asserted by the taxpayer. Where the period for measuring taxable profits is a year, every transaction of profit and loss of that year enters into the amount "accumulated" therein. Where the period for basing the tax *exceeds* a year, likewise every transaction of profit or loss in the longer period must enter into the amount "accumulated" therein. There is no other way to compute accumulations over a period.

The word "accumulated" is used several times in Section 201. In sub-paragraph (b), the two periods before and after March 1, 1913, are brought into sharp contrast. It contains these words:

> "any earnings or profits *accumulated* or increase in value of property accrued *prior to March 1, 1913,* may be distributed exempt from the tax, after the earnings and profits *accumulated since February 28, 1913,* have been distributed."

The word "accumulated" is here twice used in the same sentence, once with reference to the *ante*-March 1, 1913, period and once with reference to the period "since February 28, 1913." In the first instance, it necessarily means the net of profits over losses in the

period from corporate organization to March 1, 1913. Can Congress be deemed to have used it in a different sense later in the same sentence with reference to the time "since February 28, 1913"? Ordinary rules of construction require it to be given the same meaning in both cases. Such rules also require that the same word in paragraph (a) of Section 201, used as it is with respect to the same subject matter, be given the same sense that it has in the above mentioned paragraph (b) of the same section. Hence, in paragraph (a) defining a taxable dividend, the words "earnings and profits accumulated since February 28, 1913" must mean the net of profit over losses from February 28, 1913, to April 14, 1923. In its ordinary sense, a sum "accumulated" in a given period is the difference between the income and the outgo of that period.* If it be established that Congress intended to create two periods, as such, by Section 201, no other meaning can be given to the word "accumulated."

The Commissioner's mode of computation not alone gives different meanings to the word "accumulated" as between paragraphs (a) and (b) of Section 201 and as between its first and second usage in the passage quoted from paragraph (b), but also as between different fact situations. If a company has had profitable years next following March 1, 1913, followed by loss years of lesser amount, the Commissioner would accept the net of operations for all these years as the "profits accumulated since February 28, 1913." If, on the contrary, the loss years came first, the net of operations only of the succeeding years

* In *Eisner* v. *Macomber*, 252 U. S. 189; 64 L. Ed. 521; 40 S. Ct. 189, the Court remarked (p. 212) that a stock dividend evidences an antecedent "accumulation of profits." This is obviously a net after deducting losses.

would be, according to his theory, the "profits accumulated since March 1, 1913." If the years of profit and loss are alternate, the net of operations for all the years is used by him, unless the first year was one of loss, in which event it is excluded.

So interpreted, a corporation with a loss of $5,000,000 in the first five years, followed by profits of $5,000,000 in the next five years, would be deemed to have "accumulated" $5,000,000 "since February 28, 1913," although its financial position at the end of the ten years is identical with its position at their beginning; whereas if the profit years had come first, followed by the loss years, the Commissioner would say that it had "accumulated" nothing in the ten years. *This gives the word "accumulated" different meanings depending upon the mere accident of the sequence of losses and profits.*

This result, he claims, flows out of an alleged bookkeeping necessity of charging all losses before a new *post*-February 28, 1913, surplus has been established, against March 1, 1913, surplus. Thus, a mere bookkeeping concept (and an erroneous one at that) is made the basis for saying that in one situation the word "accumulated," in Section 201, means the net profits for the whole series of years and in the other the net profits for only certain of those years,—in this instance seven and a fraction out of ten and a fraction years, "since February 28, 1913." It is our conception that in interpreting the statute its meaning should first be found by ascertaining the broad intent of Congress. When that has been ascertained, mere bookkeeping considerations — even if they be valid as such—must give way to that intent. The statute must not yield to bookkeeping. Bookkeeping

must find a way (and there is here a ready way) to conform to the statute.

This Court has often looked through mere bookkeeping entries to the underlying facts, as in *Southern Pacific Co.* v. *Lowe,* (*infra*) 247 U. S. 330, and in *Gulf Oil Corporation* v. *Lewellyn,* (*infra*) 248 U. S. 71 and in *Old Colony Railroad Company* v. *Commissioner,* 284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211; and has frankly said that it is not bound by mere bookkeeping.

The Circuit Court of Appeals for the Ninth Circuit fell into the same error of interpreting the statute by a resort to bookkeeping. It said flatly with respect to the argument above presented:

> "The argument ignores both bookkeeping and reality."

It conceived that an operating loss after February 28, 1913, and before the building up of a surplus for the period following that date, had to be charged against the surplus of March 1, 1913, *as a matter of bookkeeping,* and that this consideration colored the language of Section 201 (a). This, we submit, is an erroneous approach to the question. Bookkeeping must be conformed to the intent of Congress, when that has been ascertained, and can be of no assistance in finding that intent. The method employed by the Commissioner merely presupposes a given interpretation of the statute.

2.

THE SURPLUS OF MARCH 1, 1913, HAVING BEEN ACCUMULATED BEFORE THAT DATE, IS NOT SUBJECT TO DIMINUTION BY SUBSEQUENT OPERATIONS AND, BEING TAX-FREE, IS TREATED BY THE REVENUE ACT OF 1921 (AND FORMER ACTS, BEGINNING WITH THE ACT OF 1916) PRECISELY AS IF IT WERE CAPITAL.

The argument of the Commissioner and of the court below reverses the proper direction of approach, which is first to ascertain the plan of the tax, the intent and reasons which lie behind it and the rational meaning of the language employed. For this, the Commissioner and the court below substitute argumentation as to how books are kept and about hazarding the surplus in the business, "restoring" the surplus, carrying profits backward or losses forward, and exemptions. The very simple thing before the Court instead is: when Congress levied a tax on the recipient of the corporate "earnings and profits accumulated since February 28, 1913," did it mean to tax a sum *greater* than the whole net profits of the Company after February 28, 1913? If it did not, but fixed that net as the maximum (as it seems clearly to have done, not alone by paragraph (a), but also by the words in paragraph (b) "to the extent of such earnings and profits accumulated since February 28, 1913") considerations of hazarding capital, replacing capital, carrying forward losses, carrying profits backward, absorbing profits—all mere accountancy conceptions—are purely extraneous matters. Just why under any rational tax plan *should* losses sustained by a company be ignored merely because they came first? The reason given is

wholly artificial. Why *should* Congress be deemed to have intended on distributions after February 28, 1913, to have taxed to the stockholder *more than the company itself made* after that time? The person claiming such an irrational intent should be required to demonstrate it from some express or unmistakably clear requirement of the language of the act itself and not by resort to the language of the bookkeeper. The rational conception is the simple one, namely, that Congress meant to reach, in the hands of the stockholder, *all* the net profits the corporation made and distributed after the enactment of the Sixteenth Amendment—*and no more,* and that it required the taxable surplus to be distributed before the non-taxable surplus of March 1, 1913.

The court below also said:

> "If, however, instead of distributing the surplus, the corporation, as in this case, subjects it to the hazards of the business, there is no provision for restoring, out of future normally taxable earnings, any part of the surplus that may thereby have been lost."

There is no need for any such provision. The surplus of March 1, 1913, is "restored" automatically by the very terms of the act. Indeed, we submit, that is its plain purpose. By the act there is nothing to tax until the second period (beginning March 1, 1913), as a period of accumulation, shows a surplus of its own. It can show no surplus as a period until its later earnings have not alone equalled the prior losses, but have exceeded them. The incidence of the tax is placed only upon such *excess, i. e.,* the "earnings and profits accumulated since February 28, 1913." By the time there is the first dollar of such

an excess, the surplus of March 1, 1913, has automatically been "restored."

This conclusion, of course, assumes that Congress has created two entire periods for measuring accumulations. If this fundamental conception of the intent of Congress has been established, the automatic "restoration" of March 1, 1913, surplus is found to be an integral part of the plan of the tax. Hence, it is evident that the real inquiry in this case is whether Congress intended to create an entire period "since February 28, 1913" for measuring taxable accumulations, and what it meant by the words "accumulated since February 28, 1913." We are not aided in that interpretation by a search for language expressly authorizing a restoration of the surplus of the *first* period, for the words under interpretation concern only the surplus of the *second* period.

The Commissioner's conception of a surplus is that of a pile of ear-marked dollars. The court below seems to have had the same conception. If then a dollar is taken from the pile, even temporarily, that dollar cannot be replaced. This is a wrong conception of a surplus, which may, and usually does, exist not so much in cash or bank credits, as in fixed assets, real estate, timber, accounts receivable, patents, good will or what not. Indeed, a balance sheet of a corporation at the end of its fiscal year may show a diminution of surplus as the result of the year's operations, yet it may actually have on hand more cash, bank credit and tangible assets than at the beginning of the year. This often happens through the mere changes in dollar value of inventories and other tangible assets. These conceptions have no place in interpreting a statute. The obviously correct ap-

proach is to find what plan of taxation was intended. All else must yield to that intent.

The Commissioner and the lower court consider March 1, 1913, surplus forever dissipated by losses immediately following that date, much as though Section 201 (b) had read:

> "But any of the earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, *and not lost in carrying on the business of the corporation between March 1, 1913, and the date of this Act,* may be distributed" * * * etc.

But the Acts of 1916 and 1921 do not read that way. They recognized March 1, 1913, surplus, as such, a fixed amount—and not as diminished or increased by subsequent occurrences. And the same language has been employed in every act since. The 1924, 1926, 1928 and 1932 Acts all provide, without any limitation whatever, that the earnings prior to March 1, 1913, may be distributed tax-free. Yet in this case the Commissioner is claiming, not that the surplus of March 1, *1913,* but the surplus of March 1, *1916,* is to be distributed tax-free.

It is conceded by the Commissioner that paid-in capital may be "restored" out of *post*-February 28, 1913, earnings, but there is no express provision in the act to that effect. It follows of necessity from the fact that it is capital. But Congress, by this provision taxing *only* the accumulations *since* February 1, 1913, has put March 1, 1913, surplus on precisely the same footing as paid-in capital, for the purposes of the act. By taxing only what was "accumulated" from operations through a given *post*-February 28, 1913, period, it has excluded from tax on distribution an amount equal to the surplus existing when the

second period began, and so for this purpose has given the prior surplus the attributes of capital. The Circuit Court of Appeals for the Seventh Circuit rightly so held in the *Canfield* case. This interpretation makes the act wholly consistent throughout, *i. e.*, if the surplus be treated as capital for the purposes of the act, the net after February 28, 1913, is automatically left to tax. Or, conversely, if the word "accumulated" means the net and that alone is taxed, the surplus of March 1, 1913, is automatically left untouched and untaxed.

This Court has repeatedly used language to the effect that March 1, 1913, surplus must be treated like capital. In *Southern Pacific Co.* v. *Lowe* (247 U. S. 330; 62 L. Ed. 1142; 38 S. Ct. 540) it said:

> "This being so, we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being capital, not income, for the purposes of the Act."

Similar statements occur also in *Gulf Oil Corporation* v. *Lewellyn* (248 U. S. 71; 63 L. Ed. 133; 39 S. Ct. 35); *Eisner* v. *Macomber* (252 U. S. 189; 64 L. Ed. 521; 40 S. Ct. 189); *Lucas* v. *Alexander* (279 U. S. 573; 73 L. Ed. 851; 49 S. Ct. 426), and *Old Colony Railroad* v. *Commissioner* (284 U. S. 552; 76 L. Ed. 484; 52 S. Ct. 211). Congress here has therefore made static the amount distributable tax-free. The Commissioner will concede that it may never be increased beyond the amount of the surplus of March 1, 1913. It is a constant, not a variable. This follows from the fact that Congress did not tax it, but taxed only something else,—the excess of profits over losses for the period after February 28, 1913. This is but another way of saying that it made the surplus of March 1, 1913, like capital for the pur-

poses of the act. These forms of expressing the same idea are all convertible. Congress itself has expressed this view of March 1, 1913, surplus. In House Report 179 (First Session of the 68th Congress) of the Ways and Means Committee, the following passage appears:

> "The theory which causes the allowance of the receipt of the dividend free of tax is that this distribution, being out of earnings accumulated prior to March 1, 1913, constitutes a return of capital to the stockholder. If it is treated as a return of capital for purposes of taxation, it should manifestly be considered a return of capital for purposes of determining his capital investment in the stock and the resulting gain or loss from its subsequent sale."

Congress has squarely recognized March 1, 1913, surplus as capital for the purposes of the income tax, by the last sentence of paragraph (b) itself. This reads:

> "If any such tax-free distribution has been made, the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in Section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon."

Under this provision, a taxpayer buying stock for, say, $400 per share, receiving a tax-free distribution of $50 per share (in addition to ordinary dividends) and then selling for $300 per share, would have had a deductible loss of $50 per share and not $100. In short, the tax-free distribution was treated by the act as a mere return of capital. There was no dif-

ference, in computing his deductible loss, between it and his original capital investment. A similar provision is found in every act since the 1921 Act,—in the following words, beginning with the 1924 Act:

> "But any such tax-free distribution shall be applied against and reduce the basis of the stock provided in Section 204" (Sec. 113 in the 1928 Act).

The 1921 Act covered only losses. The 1924 and later acts applied the same rule also in measuring profits.

The court below seemed to feel that *Lynch* v. *Hornby* (247 U. S. 339; 62 L. Ed. 1149; 38 S. Ct. 543) is inconsistent with our view that the Act of 1921 made March 1, 1913, surplus as if it were capital for the purposes of the act. It is not inconsistent. *Lynch* v. *Hornby* was decided under the 1913 Act, and Section 2 (a) of the 1916 Act (defining a taxable dividend in substantially the language of the 1921 Act) was passed to change the rule of *Lynch* v. *Hornby*. With that provision, March 1, 1913, surplus became untaxed on distribution. The tax henceforth was to be laid, not on dividends as such, but only upon one specific variety of dividend,—namely, one from earnings made *after* March 1, 1913. Thus, March 1, 1913, surplus was put in exactly the same position as though it were capital, for both it and paid-in capital, or paid-in surplus, could be distributed tax-free. That provision was repeated, in the 1921 Act, and, hence, we insist, the March 1, 1913, surplus was under it to be treated precisely as capital for the purposes of the act.

The Commissioner has not at all times relied upon his bookkeeping concept of the statute and upon the theory that March 1, 1913, surplus is permanently dissipated by losses occurring in the first years following February 28, 1913, but up to and through the Board of Tax Appeals chiefly urged what he has termed his "retrogressive" method of arriving at accumulations "since February 28, 1913." This he bases upon certain words occurring in paragraph (b) of Section 201.

The pertinent part of that paragraph reads:

> (b) "For the purposes of this Act, every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed."

The Commissioner isolates the first twenty-four words of this paragraph and, in particular, the words "most recently accumulated," and from them concludes that the proper mode of arriving at the accumulations of the taxable period as against the accumulations of the non-taxable period, is to begin with the last year of the operations of the taxable period and then to add to its earnings those of the next prior year, and so on up the column until the loss years are encountered, whereupon he stops. This eliminates the loss years from the reckoning. His tabulations in this case (Trans., 43-45) do not follow this method in form, but as the result there reached happens to coincide with the result that would occur if he applied the "retrogressive" method of compu-

tation (inasmuch as there were no loss years alternating with profit years) he has sought to justify the tabulation in the transcript by these isolated words of paragraph (b).

These words have no such effect. They have reference only to differences in the taxing of distributions as between the several years of the *post*-February 28, 1913, period as to which the policies of Congress have from time to time varied. They have nothing to do with the mode of arriving at the taxable and non-taxable portions of a dividend *as between the two periods before and after March 1, 1913,* as to which the policy of Congress has never changed. This is readily demonstrated by the legislative history of paragraph (b). It shows that the "retrogressive" theory of the Commissioner in computing the taxable portion of a dividend declared in part from March 1, 1913, surplus is without foundation. The taxable portion is to be computed by including all years of the period instead of working upwards and backward to and stopping with loss years.

3.

THE OPINION OF THE CIRCUIT COURT OF APPEALS.

The Court below in support of its conclusion, asserts that the officials of the Treasury Department have for years interpreted Section 201 as the Commissioner here construes it. The first ruling of the Treasury Department was in 1920 (A. R. M. 82; 3 Cumulative Bulletin 36). We are construing the 1921 Act. It can hardly be conceived that failure of Congress to insert a provision in the 1921 Act specifically negativing that obscure ruling can be deemed

an approval of it. No showing has been made that Congress knew of it then—or indeed even in 1932. Actual cases in the Board of Tax Appeals or the Courts have only just begun. *Hadden* v. *Commissioner* (49 Fed. (2d) 709; C. C. A. 2, 1931) was the first case presenting the issue—and the Commissioner and the Court below insist that even it does not do so. Thus the first cases on the issue, which the Commissioner will concede have ever reached the Board of Tax Appeals or the courts, are these present *Canfield* and *Thorsen* cases, and the first case upon that issue ever to be decided by any court—the *Canfield* case—was there determined adversely to the Commissioner's interpretation.

Even though Congress were shown to have known of the 1920 ruling (or later ones) and had then failed to amend the section in the 1921 or later acts, no inference of approval could be drawn therefrom, for Congress may well have deemed the language of Section 201 (a) to be plain and sufficient and have relied upon the courts correctly to construe it. Congress cannot be expected by legislation to anticipate or to catch up with all the errors of the Commissioner. It has definitely asserted the position we present, for in House Report 179 (*supra*, p. 28) and Senate Report 398 of the First Session of the Sixty-Eighth Congress, it expressly recognized March 1, 1913, surplus as capital for the purposes of the act. Certainly, a Government department cannot by misinterpreting a statute, even through a period of years, bind the courts to an erroneous conclusion nor require Congress to negative its construction.

Burnet v. *Chicago Portrait Company*, 285 U. S. 1; 76 L. Ed. 587; 52 S. Ct. 275.

We have pointed out the mistaken approach of the court below to the real question in this case. The problem is simply to determine what portion of the dividend Congress made subject to the tax. The answer must be found in the correct interpretation of Section 201 (a). But the court below, we respectfully submit, has centered its attention on Section 201 (b), which merely supplements and in no wise limits (a). It seems principally to have considered what part of the dividend was distributable tax-free. Then, laboring under what we must characterize as a wholly indefensible conception of the real nature of a corporate surplus, it arrived at a wrong conclusion.

In its opinion, the court below seems to have ignored the well settled rules of construction of tax laws; to have failed properly to consider that part of the statute from which alone the authority to tax that part of the dividend accumulated after February 28, 1913, is taxed; to have misconstrued the meaning of the word "accumulated" as used in the law and to have overlooked the plain intent of the law to create two distinct periods—one for accumulations to be taxed and another for accumulations to be distributed tax-free.

The court below, in effect has construed Section 201 so that it does not have uniform application in that it would make the amount of the tax depend, not on the real position of the corporation, but on the mere sequence of losses and profits. Such a construction does violence to the plain words of the law.

Putting first things first, the Circuit Court of Appeals for the 7th Circuit approached the problem in this case by considering at the outset the question of

what part of the dividend was taxable under the law and reached a solution which, we submit, is indubitably right.

Its solution is in accord with the clear and pointed dissenting opinion of the minority of the Board of Tax Appeals and, it may be noted, in accord with the view of the entire Board when it came to reconsider precisely the same question in the Walker case.

We submit that the judgment in this case should be reversed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 212

WILLIAM R. THORSEN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 84–93) is reported in 65 F. (2d) 234. The opinion of the Board of Tax Appeals (R. 54–65) is reported in 24 B.T.A. 480.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 19, 1933. (R. 93–94.) The petition for a writ of certiorari was filed June 29, 1933, and was granted October 9, 1933. (R. 99.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

18060—33

QUESTION PRESENTED

Whether, in determining what part of a distribution declared and paid by a corporation to its stockholders in 1923 represented earnings or profits accumulated prior to March 1, 1913, and was therefore exempt from tax, losses sustained by the corporation in 1915 and 1916 are to be regarded as diminishing the surplus existing on March 1, 1913, or as reducing the profits accumulated between 1916 and 1923.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the appendix to the brief for the petitioner in *Guy T. Helvering, Commissioner of Internal Revenue,* v. *Charles J. Canfield,* No. 158, October Term, 1933.

STATEMENT

The facts in this case are in all material respects identical with those involved in the case of *Guy T. Helvering, Commissioner of Internal Revenue,* v. *Charles J. Canfield,* No. 158, October Term, 1933, and reference is made to the statement in the brief for the petitioner in that case. The petitioner in the instant case owned 3,270 shares of the capital stock of the West Side Lumber Company. (R. 51.) On April 14, 1923, the company declared a dividend of $5,100,000, of which the petitioner received $1,111,800. (R. 53.) The Commissioner of Internal Revenue contended before the Board of Tax Appeals that of this dividend 22.75% was taxable

as being paid out of earnings accumulated since February 28, 1913, while the petitioner claimed that only 14.91% was so taxable. (R. 54.) As in the *Canfield* case, *supra,* the difference depends upon the proper application of the losses sustained by the corporation in the fiscal years 1915 and 1916. The Board of Tax Appeals (seven members dissenting) sustained the ruling of the Commissioner. (R. 54–65.) The Circuit Court of Appeals affirmed the decision of the Board. (R. 84–94.)

ARGUMENT

The question in this case is the same as that in the *Canfield* case, *supra,* and the two cases have been assigned for argument together. In the interest of brevity the respondent adopts and incorporates herein by reference the argument presented in the brief filed in his behalf in the *Canfield* case. For the reasons there stated it is submitted that the decision of the Circuit Court of Appeals for the Ninth Circuit is correct and should be affirmed.

Respectfully submitted.

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WILLIAM R. THORSEN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose the petition.

The case arises under Section 201 (a) and (b) of the Revenue Act of 1921, which is set forth in the Appendix, *infra,* p. 4.

The question presented is whether, for the purpose of fixing the taxable status of a dividend declared and paid in 1923, losses incurred in 1915 and 1916 should be used to reduce the 1913 surplus or the profits accumulated from 1917 to 1923.

The Circuit Court of Appeals ruled that losses incurred subsequent to February 28, 1913, are

chargeable against preexisting surplus and are not to be regarded, for the purposes of the statute, as suspended to be paid out of later possible profits (R. 84–93; 65 F. (2d) 234). The court below, in so holding, affirmed the majority decision of the Board of Tax Appeals (R. 50–63; 24 B.T.A. 480).

The decision below presents a direct conflict with that of the Circuit Court of Appeals for the Seventh Circuit in *Canfield* v. *Commissioner,* 62 F. (2d) 751. The *Canfield case* involved another stockholder of the same corporation, and the two cases were consolidated for hearing and decision before the Board of Tax Appeals. The decision of the Board was reversed in the *Canfield case* and affirmed in the instant case. In addition to the clear conflict, the importance of the question is admitted by both parties, and is one of the grounds relied upon by the Commissioner of Internal Revenue in the petition for writ of certiorari in the *Canfield case,* No. 158, this term. This petition was not opposed.*

While we concede the desirability of review by the Court, we believe the case to have been correctly decided below. The reasoning in support of the conclusion is so clearly and ably stated by

*After the time for filing a brief in opposition, as governed by the rules of this Court, had expired and after this memorandum went to print, a "Reply Brief" was filed to the petition in the *Canfield* case. This brief concedes the conflict between the *Thorsen* and *Canfield* cases. It does not question the importance of the issue or the desirability that it be reviewed by this Court.

the Circuit Court of Appeals that it is believed no further exposition of our views is necessary at this point.

An early determination by this Court of the question presented will greatly facilitate the administration of the revenue laws and will undoubtedly forestall considerable litigation in the future.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.

AUGUST 1933.

APPENDIX

STATUTE INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 228:

SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal-service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

U. S. GOVERNMENT PRINTING OFFICE: 1933

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 158

[illegible] T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES J. CANFIELD

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 34131

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances:

For Taxpayer: Andrew L. Campbell, C.P.A., Edwin H. Cassels, Esq.

For Comm'r.: Harold Allen, Esq., H. D. Thomas, Esq., Willis R. Dansford, Esq.

Docket entries

1928

Jan. 20—Petition received and filed. Taxpayer notified. (Fee paid.)

Jan. 21—Copy of petition served on general counsel.

Mar. 17—Answer filed by general counsel.

Mar. 20—Copy of answer served on taxpayer. General calendar.

1930

Feb. 19—Hearing set April 3, 1930.

Mar. 21—Motion to place on the reserve calendar, filed by general counsel. March 24, 1930, granted.

Aug. 19—Hearing set October 28, 1930.

Oct. 13—Motion to consolidate with docket 38095 and to postpone hearing to October 30, 1930, or thereafter, filed by taxpayer.

Oct. 15—Order of continuance to Oct. 30, 1930, for hearing on merits, entered. See 38095.

Oct. 30—Hearing had before Mr. Seawell, div. 4. Called on merits. Stipulation of facts filed. Briefs due in 60 days.

Nov. 12—Transcript of hearing Oct. 30, 1930, filed.

Dec. 27—Brief filed by taxpayer.

Dec. 29—Brief filed by general counsel.

1931

Jun. 12—Findings of fact and opinion rendered, Mr. Seawell, div. 4. Judgment will be entered under rule 50.

Jun. 29—Order that pursuant to section 601 (b) of Revenue
2 Act of 1928, the decision promulgated June 12, 1931, be reviewed, entered.

Aug. 6—Stipulation to file supplemental brief, filed.

Aug. 7—Order granting 30 days for petitioner and Commissioner to file supplemental briefs, entered.

Aug. 8—Supplemental memo. brief filed by taxpayer.

Sept. 3—Supplemental memo. brief filed by general counsel.

Oct. 27—Findings of fact and opinion rendered, Mr. Seawell, div. 4. Judgment will be entered under rule 50.

Nov. 23—Notice of settlement filed by general counsel.

Dec. 1—Hearing set Dec. 16, 1931, on settlement.

Dec. 16—Consent to settlement filed by taxpayer.

Dec. 16—Hearing had before Mr. Smith, div. 5, on settlement under rule 50. Referred to Mr. Seawell.

Dec. 21—Decision entered, Mr. Seawell, div. 4.

1932
Feb. 1—Petition for review to U. S. Circuit Court of Appeals (7) with assignments of error, filed by taxpayer.
Feb. 1—Praecipe filed.
Feb. 15—Proof of service of petition filed.
Mar. 10—Proof of service of praecipe filed.

Before United States Board of Tax Appeals

Petition

Filed Jan. 20, 1928

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:FAR:B-1:RRP-60D), dated November 25, 1927, and as a basis of his petition alleges as follows:

1. Petitioner is an individual, residing at 199 Lake Shore Drive, Chicago, Illinois, and having his principal office at 38 South Dearborn Street, Chicago, Illinois.

3 2. On or about November 25, 1927, the Commissioner of Internal Revenue mailed at Washington, D.C., to the petitioner at the above address a letter and notice of deficiency, claiming a deficiency in tax in the amount of $9,243.66 for the taxable year 1923, a copy of which notice of deficiency is hereto appended and marked "Exhibit A." An earlier letter is also attached marked "Exhibit C."

3. The taxes in controversy are income taxes for the calendar year 1923 in the amount of $9,243.66.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(I) The Commissioner of Internal Revenue erred in holding that the dividends received by this petitioner from West Side Lumber Company on, to wit, April 14, 1923, were 28.217% taxable (exhibit A), whereas such dividends were only 15.23% taxable.

(II) The Commissioner erred in computing the statutory taxable income of the petitioner by including therein the aforementioned dividends in the amount of 28.21% of $204,000 or $57,562.68 (exhibit A), whereas such dividends should have been included only in the amount of 15.23% of $204,000 or $31,069.20.

(III) The Commissioner erred in determining and assessing income taxes upon the statutory taxable income of the petitioner computed by including therein at least $26,493.48 out of a distribution made by West Side Lumber Company on April 14, 1923, out of surplus of such company accumulated prior to March 1, 1913 (exhibit A).

(IV) The Commissioner erred in holding that the net losses of $193,139.67 and $211,707.32 sustained by West Side Lumber Company in its fiscal years March 1, 1914—February 28, 1915, and March 1, 1915—February 29, 1916, are not to be considered in determining

the amount of earnings "accumulated" during the period March 1, 1913—April 14, 1923, and distributed on April 14, 1923, by West Side Lumber Company to its stockholders within the meaning of section 201 of the Revenue Act of 1921, whereas such losses should be deducted from the total of the earnings of the several fiscal years of the period March 1, 1913—April 14, 1923, in determining the amount of earnings "accumulated" during such period (Exhibit B).

4 (V) The Commissioner erred in holding that a certain sum, i.e., an amount equal to the losses of $193,139.67 and $211,707.32, sustained in the fiscal years ending February 28, 1915, and February 29, 1916, to wit: $404,846.99, was on April 14, 1923, paid by West Side Lumber Company out of its earnings accumulated subsequent to March 1, 1913, whereas in fact such sum was distributed out of capital and surplus accumulated prior to March 1, 1913 (exhibit B).

(VI) The Commissioner erred in holding that when West Side Lumber Company declared and paid to its stockholders on April 14, 1923, a dividend of $340.00 per share it distributed as a part thereof the entire net earnings of its fiscal year of March 1, 1923, February 29, 1924, to wit, $311,209.54 (exhibit B), whereas he should have held that he then distributed only 44/366ths of such sum, or $37,413.17.

(VII) The Commissioner erred in holding that a certain sum, i.e., 322/366ths of $311,209.54, to wit, $273,796.37, paid by West Side Lumber Company to its stockholders on April 14, 1923, was not paid out of the surplus accumulated by it prior to March 1, 1913.

(VIII) The Commissioner erred in determining that the income tax liability of the petitioner for the calendar year 1923 disclosed a deficiency in the amount of $9,243.66 (exhibit A).

(IX) The Commissioner erred in determining that the income tax liability of the petitioner for the calendar year 1923 disclosed a deficiency in any amount whatsoever, and in not finding that there had been an overassessment of income taxes against the petitioner for such year.

5. The facts upon which the petitioner relies as the basis of this proceedings are as follows:

(a) The taxpayer on March 14, 1924, filed his income-tax return for the calendar year 1923 reporting a net taxable income of $140,656.86. Included in such sum of $140,656.86, was an item of $33,360.00 returned as taxable income from a certain dividend received by him on April 14, 1923, with respect to 600 shares of common stock of that date owned by the taxpayer in the West Side Lumber Company. Upon this total of $140,656.68 of taxable net income, the income tax, normal and surtax, was computed at $37,222.57 and this sum was duly paid in four quarterly installments in the year 1924.

(b) West Side Lumber Company is a California corporation. Its capitalization on April 14, 1923, consisted of 15,000 shares of common stock of the par value of $100 per share. It has

5 continuously owned since March 1, 1913, all of the capital stock of Tuolumne Lumber Company. In 1906 the taxpayer acquired the above-mentioned 600 shares of the common stock of West Side Lumber Company and continuously thereafter owned the same through the taxable year 1923. On March 1, 1913, West Side Lumber Company had a surplus of $4,332,684.78, so that each share of its common stock had a book value of $388.85 on that date. The fiscal year of the company was and is the first day of March in each year to and including the last day of February in each year.

(c) The consolidated earnings of West Side Lumber Company and its subsidiary and the dividends paid by West Side Lumber Company after March 1, 1913, were as follows:

	Earnings	Dividends
Year ending February 28, 1914	$4,594.62	
" " " 28, 1915	−193,139.67	
" " " 29, 1916	−211,707.32	
" " " 28, 1917	60,495.56	
" " " 28, 1918	57,901.55	$90,000.00
" " " 28, 1919	208,737.34	
" " " 29, 1920	543,490.33	75,000.00
" " " 28, 1921	640,837.43	375,000.00
" " " 28, 1922	182,954.63	300,000.00
" " " 28, 1923	718,858.29	450,000.00
March 1 to April 14, 1923 (incl.); 44/366ths of $311,209.54	37,413.17	
	2,050,435.93	1,290,000.00

The difference between earnings and dividends paid for the period March 1, 1913–April 14, 1923, was $760,435.93, to which should be added sundry adjustments amounting to $16,323.04 (chiefly earnings of Tuolumne Lumber Company prior to March 1, 1917, which the Commissioner has omitted from his statement, exhibit B—less sundry donations, coupon tax, etc.), so that the consolidated surplus on April 14, 1923, was $5,109,443.75, or an increase of $776,758.97 over that of March 1, 1913. The book value of the common stock on April 14, 1923, was $440.63 per share. The net earnings of the company and its subsidiary for the period March 1, 1923–February 29, 1924, were $311,209.54 and the net earnings of the company and its subsidiary for the period April 15, 1923–February 29, 1924, were 322/366ths of $311,209.54, i.e., $273,796,37.

Attached hereto and made a part hereof as exhibit B is a letter dated August 25, 1927, and signed by the Commissioner. All the figures in the tabulation foregoing are set forth in such letter of the Commissioner as the correct earnings and losses of said

6 several years, with the exception of the figures of $208,737.34 and $37,413.17 for which the Commissioner substituted the figures of $289,937.34 and $311,209.54. The figures of $289,937.34 has been later corrected by the Commissioner (exhibit A) to $208,737.34 in computing the present alleged overassessment of $9,243.66. The figure of $311,209.54 used by the Commissioner represents the entire net earnings of the period March 1, 1923–February 29, 1924, while the figure of $37,413.17 is 44/366ths of $311,209.54

(i.e., the prorated earnings of the period March 1, 1923–April 14, 1923). The taxpayer accepts as correct the several figures used by the Commissioner as to the earnings of West Side Lumber Company in the several years March 1, 1913–February 29, 1924, except that of $289,937.34, but asserts that it is not proper to use the sum of $311,209.54 in computing the distribution from accumulated earnings made April 14, 1923, but that 44/366ths of that figure should be used.

(4) The surplus of March 1, 1913, was not in such form that it could be used for working capital, and it was necessary in 1915 and 1916 to borrow to pay current indebtedness resulting from the losses in those years. On September 15, 1915, the company issued its $700,000 first mortgage 6% Gold Bonds maturing, $175,000 each, March 15, 1918, September 15, 1920, March 15, 1923, and September 15, 1925. It paid and retired all these bonds out of its earnings of the period March 1, 1916, to March 1, 1923, as follows: March 15, 1918, $175,000; September 15, 1920, $175,000; February 28, 1921, $116,000; February 28, 1922, $57,000; February 28, 1923, $60,000; March 15, 1923, $117,000.

(e) On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000 upon its 15,000 shares of common stock, or a sum of $340 per share. The amount received by the taxpayer with respect to his above 600 shares from this distribution was $204,000 of which $31,069.20 was from earnings of the company for the period March 1, 1913–April 14, 1923, and $172,930.80 from its capital and surplus of March 1, 1913. However, he reported in his return of March 14, 1924, as taxable income from this source the sum of $33,360 instead of such sum of $31,069.20. The taxpayer now contends that instead of reporting too little taxable income from this source, he reported all his taxable income therefrom and he reported $2,230.80 too much.

(f) The Commissioner of Internal Revenue in arriving at the conclusion that the said dividend of $204,000 received by the taxpayer April 14, 1923, was 28.217% taxable considered:

7 (1) That the total of the earnings set forth in subparagraph (c), supra, in the several years of the period March 1, 1913–April 14, 1923, constituted the accumulated earnings of the company since March 1, 1913, without deduction for the losses of $193,139.67 and $211,707.32, respectively, for the year ending February 28, 1915, and February 29, 1916, and hence that these sums, or a total of $404,846.99, should be added to the above-mentioned sum of $776,758.97 (the difference between net earnings and dividends paid for the period March 1, 1913–April 14, 1923) in determining the "accumulated earnings" for the period March 1, 1913–April 14, 1923, and that the amount deemed distributed from the surplus of the company of March 1, 1913, should be diminished correspondingly by the same sum of $404,846.99, and

(2) That the earnings of West Side Lumber Company of $273,796.37 in the period April 15, 1923–February 28, 1924, were

distributed on April 14, 1923, and hence that the amount of the surplus of March 1, 1913, that was distributed on April 14, 1923, should correspondingly be reduced by the same amount below the figures arrived at by West Side Lumber Company;

The Commissioner, therefore, computed that, taking into consideration the above items of $404,846.99 and $273,796.37 and without considering the adjustment of $16,323.04, the amount of the March 1, 1913, surplus that was distributed April 14, 1923, was $1,439,079.29 and the amount of the earnings accumulated after March 1, 1913, distributed April 14, 1923, was $3,660,920.71 instead of the respective sums of $776,758.97 and $4,323,241.03 from said two sources claimed herein.

The Commissioner in consequence ruled that the income derived by the taxpayer from said 600 shares of stock on April 14, 1923, was 28.217% taxable and that the taxpayer instead of returning $33,360 as taxable income from this source (or $31,069.20 as now contended by the taxpayer) should have returned the sum of $57,562.68. The additional assessment of $9,248.66 is computed on the basis of the inclusion in the taxpayer's return as taxable income of such sum of $57,562.68 in lieu of $33,360 or $31,069.20.

The taxpayer contends (1) that the above losses of $193,139.67 and $211,707.32 should be deducted from the net earnings of the several fiscal years of the period March 1, 1913–April 14, 1923, in determining the amount of earnings accumulated after March
8 1, 1913, (2) that the earnings of $273,796.37 of the period April 15, 1923–February 29, 1924, were not distributed April 14, 1923, and (3) that sundry adjustments aggregating $16,323.04 should be included in earnings subsequent to March 1, 1913; hence that the total of earnings accumulated since March 1, 1913, and distributed April 14, 1923, was $776,758.97 and that said dividend was only 15.23% taxable, and that in consequence the taxpayer's taxable income from this source in 1923 was 15.23% of $204,000 or $31,069.20.

Wherefore, the petitioner prays that this Board may hear the claims of the petitioner; that it may redetermine the alleged deficiency in such notice of deficiency, that it may direct the Commissioner of Internal Revenue to recompute the income taxes of the taxpayer for the year 1923 in conformity with the claims and matters hereinbefore set out, and that it may find that there is no deficiency in the return of the taxpayer made March 14, 1923, or in the taxes paid by him based on said return, but that he has in fact paid for the year 1923 a greater tax than was lawfully due from him.

CHARLES J. CANFIELD,
CHARLES J. CANFIELD,
38 South Dearborn Street, Chicago, Illinois.
ANDREW L. CAMPBELL,
EDWIN H. CASSELS,
Attorneys for taxpayer.

[Duly sworn to by Charles J. Canfield, jurat omitted in printing.]

9 *Exhibit "A" to petition*

TREASURY DEPARTMENT,
Washington, Nov. 25, 1927.

(Seal) Office of Commissioner of Internal Revenue.

IT:FAR:B-1
RRP-60D

MR. CHARLES J. CANFIELD,
199 Lake Shore Drive, Chicago, Illinois.

SIR: The determination of your tax liability for the years 1923 and 1924 discloses a deficiency of $9,243.66 for the year 1923, as shown by the attached statement.

In accordance with the provisions of section 274 of the Revenue Act of 1926 you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D.C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision or such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the collector of internal revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed form A, and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:FAR:B-1-RRP-60D. In the
10 event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.
By C. B. ALLEN,
Deputy Commissioner.

Inclosures:
Statement
Form A
Form 882
Form 7861—Revised Mar. 1926.

Statement

IT:FAR:B-1
RRP-60D

In re: Mr. Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois

Year	Deficiency in tax
1923	$9,243.66
1924	None
Total	$9,243.66

The report of the internal-revenue agent in charge at Chicago, Illinois, transmitted to this office under date of May 14, 1927, has been reviewed and approved with the following exception:

1923

As a result of the reduction in the 1919 earning of the West Side Lumber Company by $81,200.00, representing stock dividends, it has been determined that your dividends received from this source in 1923 were 28.217% instead of 29.81%. This adjustment reduces the proposed deficiency from $10,437.93 to $9,243.66.

Payment of the tax in question should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

11 *Exhibit "B" to petition*

TREASURY DEPARTMENT,
Washington, Aug. 25, 1927.

(Seal) Office of Commissioner of Internal Revenue.

Address reply to Commissioner of Internal Revenue and refer to IT:FAR:B-1 RRP.

Mr. ANDREW L. CAMPBELL,
105 South La Salle Street, Chicago, Illinois.

In re: Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois.

SIR: Reference is made to your letter dated August 10, 1927, relative to a proposed additional tax of $10,437.93 against the above-named individual for the year 1923.

In accordance with your request the computations, showing how it was determined that the dividends of the West Side Lumber Company were 29.81% taxable, are set forth below.

Your attention is called to the fact that net losses incurred in any year do not affect earnings available for dividends, in accordance with the decision of the United States Court of Claims in the case of Frank P. Blair vs. the United States.

In G. C. M. 1386, Bulletin VI(27)-12, page 2, it is held that under the revenue acts the corporate earnings of the entire year should be taken as a unit in determining the amount available for dividends, and not merely the earnings up to the date a dividend was paid.

It will be noted that the figures used are those which resulted from the final office adjustments of the corporation returns.

12 *Statement of West Side Lumber Company, surplus account, March 1, 1913, to March 1, 1924*

Surplus, March 1, 1913		$4,332,684.78	
Subsequent earnings, profit from operations (per final office adjustments):			
Year ending February 28, 1914		$4,594.62	
Year ending February 28, 1915		(193,139.67)	Loss.
Year ending February 28, 1916		(211,707.32)	Loss.
Year ending February 28, 1917		60,495.56	
Year ending February 28, 1918		57,901.55	
Year ending February 28, 1919		289,937.34	
Year ending February 28, 1920		543,490.33	
Year ending February 28, 1921		640,837.43	
Year ending February 28, 1922		182,954.63	
Year ending February 28, 1923		718,858.29	
Year ending February 28, 1924		311,209.54	(per G.C.M. 1386).
Total earnings available for dividends		$2,810,279.29	
Less dividends paid:			
Year ending February 28, 1918	$90,000.00		
Year ending February 28, 1919	450,000.00		
Year ending February 28, 1922	300,000.00		
Year ending February 28, 1923	450,000.00		
		1,290,000.00	
Surplus, February 28, 1924		$1,520,279.27	
Dividend declared April 14, 1923		5,100,000.00	
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		$3,579,720.71	

From these figures it will be seen that $1,520,279.24, or 29.81% of the dividend paid on April 14, 1923, represents taxable income.

You are advised that a copy of this letter is being forwarded to the internal revenue agent in charge at Chicago, Illinois.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By PORTER LINDER,
Head of Division.

13 *Exhibit "C" to petition*

(960M) Form NP-1a

TREASURY DEPARTMENT,
Washington, July 9, 1927.

(Seal) Office of Commissioner of Internal Revenue.

Address reply to Commissioner of Internal Revenue and refer to IT:PA:1:LVH.

Mr. CHARLES J. CANFIELD,
199 Lake Shore Drive, Chicago, Illinois.

SIR: An audit of your income-tax returns for the years 1923 and 1924, in connection with the report dated May 14, 1927, of the in-

ternal-revenue agent in charge at Chicago, Illinois, disclosed a deficiency of $10,437.93 for the year 1923, as shown in the attached statement.

Enclosed you will find a statement indicating adjustments proposed by this office based upon recommendations of the revenue agent above indicated. If you acquiesce in the proposed adjustments as shown in this letter and the accompanying statement, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D.C., for the attention of IT:PA:1:LVH. In the event that you acquiesce in a part of such proposed adjustments the form should be executed with respect to the items to which you agree.

If, however, you do not acquiesce, you are granted 30 days from the date of this letter within which to present a protest with the internal-revenue agent in charge, 426 Federal Building, at Chicago, Illinois, against the adjustments proposed herein. The protest and any additional statements of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of
14 an individual the residence, and in the case of a corporation the principal office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of the proposed adjustments with respect to which the protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (e) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the date of mailing of the registered letter (not counting Sunday as the sixtieth day) in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Respectfully,

C. R. NASH,
Assistant to the Commissioner.
By E. A. COOK,
Acting Head of Division.

Enclosures:
Statement
Form A
Form 882.

Statement

IT:PA:1:LVH JUL. 9, 1927.

In re: Mr. Charles J. Canfield, 199 Lake Shore Drive, Chicago, Illinois.

Year	Deficiency in tax
1923	$10,437.93
1924	None

The report dated May 14, 1927, of the internal-revenue agent in charge at Chicago, Illinois, has been reviewed and approved except as follows:

15 The dividends of $204,000.00 received by you on April 14, 1923, from the West Side Lumber Company have been determined to be 29.81% taxable. Your taxable dividends from this source are, therefore, $60,812.00 instead of $33,360.00 as shown in the report.

This adjustment increases your total net income to $169,108.86, and indicates a deficiency as shown by the following computation:

Total tax		$63,590.53
Less:		
25% reduction, Revenue Act of 1924	$15,897.63	
Tax paid at source	32.40	
		15,930.03
Balance		47,660.50
Tax assessed	49,630.09	
Less: 25% reduction, Revenue Act of 1924	12,407.52	
		37,222.57
Deficiency		10,437.93

Payment of the deficiency in tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Before U.S. Board of Tax Appeals

Answer

Filed March 17, 1928

Comes now the Commissioner of Internal Revenue, by his attorney C. M. Charest, general counsel, Bureau of Internal Revenue, and for answer to the petition of his taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.

4(I) to 4(IX), inclusive. Denies the averments contained
16 in subparagraphs (I) to (IX), inclusive, of paragraph 4 of the petition.

5(a). Admits that the petitioner filed its return for the year 1923 on or about March 14, 1924, and that such return showed a net taxable income of $140,656.86. Admits that the petitioner reported thereon an item of $33,360.00, representing dividends. Denies each and every other material allegation of fact set forth in paragraph 5(a) of the petition.

5(b). Admits that the West Side Lumber Company is a California corporation. For lack of information denies each and every other material allegation of fact set forth in paragraph 5(b) of the petition.

5(c)(d). Denies the material allegations of fact contained in paragraph 5, subparagraphs (c) and (d) of the petition.

5(e). Admits that in April 1923 the West Side Lumber Company paid a dividend of $5,100,000.00 or $340.00 a share. Admits that petitioner received in such distribution the sum of $204,000.00. Admits that the petitioner reported as income from such distribution the sum of $33,360.00. Denies each and every other material allegation of fact set forth in paragraph 5, sub-paragraph (e) of the petition.

5(f)(1)(2)(3). Admits that the Commissioner determined that the income derived by the petitioner from 600 shares of stock in 1923 was 28.217% taxable and that the petitioner should have returned as taxable income therefrom the sum of $57,562.68. Admits that the deficiency of $9,243.66 is computed on the basis of including in the petitioner's taxable income the sum of $57,562.68 instead of $33,360.00. Denies each and every other material allegation of fact set forth in paragraph 5, subparagraph (f) (1), (2) (3), of the petition.

Denies generally and specifically each and every allegation of error and of fact contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
BENTON BAKER,
Special Attorney,
Bureau of Internal Revenue.

17 Before U.S. Board of Tax Appeals

Memorandum of facts

Filed at Hearing Oct. 30, 1930

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that for the purpose of this proceeding the following facts may be accepted as true:

1

The items of gross income, the deductions therefrom, and the net income shown in petitioner's 1923 return were as follows:

Gross income		
Interest received		$120,880.63
Dividends received		39,367.00
		$160,247.63
Deductions		
Partnership losses	$3,735.47	
Interest paid	14,391.48	
Taxes paid	137.79	
Bad debts	1,000.00	
Office expenses	326.03	
		19,590.77
Net income shown in petitioner's 1923 return		$140,656.86

2

The item of dividends amounting to $39,367.00 included in gross income in the petitioner's 1923 return consisted of:

Dividends received from the West Side Lumber Company on or about February 12, 1923, amounting to $10 a share on 600 shares, or	$6,000.00
Dividends received from the West Side Lumber Company on or about April 14, 1923, amounting to $340.00 a share on 600 shares, or $204,000 of which the petitioner reported as taxable income, an amount equal to $55.60 per share on 600 shares, or	33,360.00
Dividends received from other corporations	7.00
Total taxable dividends shown in petitioner's 1923 return	$39,367.00

18

3

The determination of tax set forth in the Commissioner's notice of deficiency was arrived at by the computations shown in exhibits A, B, and C, attached to the petition, which are true and correct copies of the Commissioner's letters dated November 25, 1927, August 25, 1927, and July 9, 1927, respectively.

4

The computation by which the Commissioner has determined that the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 28.217% taxable is as follows:

Statement of West Side Lumber Company surplus account, March 1, 1913, to March 1, 1924

Surplus March 1, 1913		$4,332,684.78
Subsequent earnings:		
Year ended February 28, 1914, profit		4,594.62
" " February 28, 1915, loss	$193,139.67	
" " February 29, 1916, loss	211,707.32	
" " February 28, 1917, profit		60,495.50
" " February 28, 1918, profit		57,901.55

Subsequent earnings—Continued.		
Year ended February 28, 1919 profit		$208,737.34
" " February 29, 1920, profit		543,490.33
" " February 28, 1921, profit		640,837.43
" " February 28, 1922, profit		182,954.63
" " February 28, 1923, profit		718,858.29
" " February 29, 1924, profit		311,209.54
Total earnings available for dividends		$2,729,079.29
Less dividends paid:		
Year ended Feb. 28, 1918	$90,000.00	
" " " " 1919	450,000.00	
" " " " 1922	300,000.00	
" " " " 1923	450,000.00	
		1,290,000.00
Surplus February 28, 1924 (28.217% of $5,100,000)		1,439,079.29
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		3,660,920.71

5

The respondent concedes that the foregoing computation should be revised to show that the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 22.75% taxable instead of 28.217% taxable, determined as follows:

19 *Statement of West Side Lumber Company surplus account, March 1, 1913 to April 14, 1923*

Surplus March 1, 1913		$4,332,684.78
Add profit for year ended Feb. 28, 1914		4,594.62
		4,337,289.40
Deduct:		
Loss for year ended Feb. 28, 1915	$193,139.67	
" " " " " " 1916	211,707.32	
		404,846.99
Surplus February 29, 1916		3,932,442.41
Subsequent earnings:		
Year ended Feb. 28, 1917		60,495.56
" " " 28, 1918		57,901.55
" " " 28, 1919		208,707.34
" " " 29, 1920		543,490.33
" " " 28, 1921		640,837.43
" " " 28, 1922		182,954.63
" " " 28, 1923		718,858.29
Period ended April 14, 1923 (44/366 of total earnings of $311.209.54 for year ended Feb. 29, 1924)		37,418.17
Total earnings March 1, 1916 to April 14, 1923		2,450,658.30
Less dividends paid:		
Year ended Feb. 28, 1918	$90,000.00	
" " " 28, 1920	75,000.00	
" " " 28, 1921	375,000.00	
" " " 29, 1932	300,000.00	
" " " 28, 1923	450,000.00	
		1,290,000.00
Surplus March 1, 1916 to April 14, 1923, (22.75% of $5,100,000)		1,160,658.30
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (non-taxable)		$3,939,341.70

The capital stock of the West Side Lumber Company during the period from March 1, 1913, to April 14, 1923, consisted of 15,000 shares having a par value of $100 each. The petitioner owned 600 shares of said capital stock during all of such period.

The surplus of the West Side Lumber Company and its earnings, losses, and dividends for the period from March 1, 1913, to April 14, 1923, were as follows:

Statement of West Side Lumber Company surplus account March 1, 1913 to April 14, 1923

Surplus March 1, 1913		$4,332,684.78
Subsequent earnings:		
Year ended Feb. 28, 1914, profit	$4,594.62	
" " " 28, 1915, loss	(193,139.67)	
" " " 29, 1916, loss	(211,707.37)	
" " " 28, 1917, profit	60,495.56	
" " " 28, 1918, profit	57,901.55	
" " " 28, 1919, profit	208,737.34	
" " " 29, 1920, profit	543,490.33	
" " " 28, 1921, profit	640,837.43	
" " " 28, 1922, profit	182,954.63	
" " " 28, 1923, profit	718,858.29	
Period ended April 14, 1923, (44/366 of total earnings for year ended February 29, 1924)	37,413.17	
		2,050,435.93
		6,383,120.71
Dividends paid:		
Year ended Feb. 28, 1918, $6	90,000.00	
" " " 29, 1920, 5	75,000.00	
" " " 28, 1921, 25	375,000.00	
" " " 28, 1922, 20	300,000.00	
September 15, 1922, 10	150,000.00	
" 18, 1922, 10	150,000.00	
February 12, 1923, 10	150,000.00	
		1,290,000.00
Surplus April 14, 1923		$5,093,120.71

21 On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock, of which petitioner received $204,000.

The right is hereby reserved by both parties to prove any additional facts not inconsistent herewith.

CHARLES J. CANFIELD, *Petitioner.*
By ANDREW L. CAMPBELL, *Attorney.*
COMMISSIONER OF INTERNAL REVENUE,
By C. M. CHAREST, *Attorney.*

Before U. S. Board of Tax Appeals

Promulgated June 12, 1931

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The

corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

Edwin H. Cassels, Esq., and Andrew L. Campbell, C.P.A., for the petitioners.

Harold Allen, Esq., and Willis R. Lansford, Esq., for the respondent.

The Commissioner determined a deficiency in income tax for 1923 of $9,243.66 in Docket No. 34131 and of $36,720.96 in Docket No. 38095, the full amount of such deficiencies being in controversy.

These proceedings are consolidated for hearing, the issue,
22 which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

Findings of fact

Filed June 12, 1931

The petitioners are individuals, Charles J. Canfield, residing and having his principal office in Chicago, Ill., and William R. Thorsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

23 The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00
September 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000 or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5.455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 percent

taxable, instead of being 28.217 percent taxable in the case of Charles J. Canfield and 25.05 percent taxable in the case of William R. Thorsen, as formerly asserted.

The petitioners contend that said dividend distribution was
24 only 14.91 percent taxable and that each reported originally more taxable income than he should have returned.

Opinion

Filed June 12, 1931

SEAWELL: The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

"SEC. 201. (a) That the term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the act exempt from the tax; that the surplus so created and existing cannot be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913", which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913", as considered in O.D. 610, C.B. 3, p. 24, and A.R.M. 82, C.B. 3, p. 36, and as likewise construed by the respondent and applied in the instant cases.

25 The respondent in making his determination excludes from consideration for the period "since February 28, 1913", the losses sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended February 29, 1916, of $211,707.32. To March 1,

1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40, from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,658.30, which respondent considers the total earnings or profits from February 28, 1913, to April 14, 1923. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,658.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000. The difference, $3,939,341.70, between the $1,160,658.30 and the $5,100,000 declared and paid as a dividend April 14, 1923, represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as *dividends in the hands of the* recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen $1,111,800, and if the respondent's method of tax computation is correct, each of the petitioners is taxable on 22.75 percent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

It is ably and plausibly argued in behalf of petitioners that the respondent has erred in his method of computation of the deficiency in tax and numerous authorities are cited to support such contention.

In considering the question it should be constantly borne in mind that in the instant cases the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78, in addition to its capital of $1,500,000.

In the year ended February 28, 1914, the company made a profit of $4,594.62 and if it had then, out of its total earnings or surplus, declared a dividend and made distribution in excess of the $4,594.62 and less than the entire surplus, the difference between the $4,594.62 and the dividend so declared would not have been taxable in the hands of stockholders, but only the amount of the earnings, $4,594.62, accumulated, since March 1, 1913, would have been taxable. In such circumstances there would apparently be no disagreement between the petitioners and the respondent as to the taxable amount and there appears to be no objection on the part of the petitioners to the manner in which the earnings or profits for the year ended February 28, 1914, were dealt with by respondent in his computation. How the losses occurring in the years ended on the last days of February 1915 and 1916 are to be considered in determining the amount of "earnings and profits accumulated since February 28, 1913", under section 201 (b) of the act, is the real issue between the parties.

In the years ended on the last days of February 1915 and 1916 the West Side Lumber Company sustained losses aggregating $404,-846.99. At the time such losses were sustained, however, they did not in fact produce an operating deficit, for the reason there were then the $4,594.62 above mentioned prior undistributed accumulated earnings or profits constituting a surplus much greater in amount than such losses and made good the same, leaving thereafter a surplus on the last day of February 1916 of $3,932,432.41. The capital of $1,500,000 was not impaired by such losses.

The evidence shows there were no losses by the West Side Lumber Company after the year ended February 29, 1916; that its total earnings March 1, 1916, to April 14, 1923, were $2,450,658.30, and there were dividend distributions of $1,290,000 prior to the latter date, on which date a dividend of $5,100,000 was declared and distributed to its stockholders, of which petitioners were two, receiving the amounts indicated in our findings of fact.

In support of petitioners' insistence that the respondent erred in his method (fully set forth in the evidence) of computing their taxable income for the year in issue, decisions in numerous cases are cited. We do not deem it necessary to discuss in detail all the cases cited and relied on by the petitioners. The questions involved and the facts stated in many of the cases are quite different from those in the instant cases. We will, however, comment very briefly on some of such cases, though none, in our opinion, is controlling.

Mutschler Bros. Co., 12 B.T.A. 731, is a case concerning the
27 restoration of capital impairment through undivided profits and involves a question of invested capital, and the brief of the petitioners states the decision therein followed the decision in Willcuts v. Milton Dairy Co., 275 U.S. 215. The facts and basic principles, however, are not the same as in the instant cases and, in our opinion, do not warrant the interpretation placed upon them by petitioner.

Southern Pac. Co. v. Lowe, 247 U.S. 330, involved surplus accumulations which accrued to a corporation prior to January 1, 1913, and were in the circumstances of that case held to be capital and not income, and does not distinguish between an accumulation of surplus earnings and the increment due to an appreciation in value of the assets of the corporation.

The case of Park v. Gilligan, 293 Fed. 129, involved a distribution as a dividend of the proceeds of a chose in action arising prior to March 1, 1913. It was held therein that an amount received in 1916 in settlement of a claim for damages existent on March 1, 1913, is not profit arising subsequent to that date. All current earnings having been distributed previously, those distributed to the shareholders after March 1, 1913, were held not to constitute a taxable dividend under the Revenue Act of 1916.

Crystal Ice Co., 14 B.T.A. 688, involved consideration of the effect on invested capital of the payment of dividends where a deficit exists

due to operation losses, the dividends having been paid before such deficit was made good. The case is not like the instant cases and no authority in support of petitioners' contention.

The case of J. L. Washburn, 16 B.T.A. 1091, is not in point, for the reason that it involves the taxability of a dividend where on the date of the distribution the corporation paying the same had a deficit in its surplus account.

In Louise Glassell Shorb, 22 B.T.A. 644, we indicated our opinion of the correctness of certain rulings of the Bureau of Internal Revenue in the matter of determining whether certain corporate distributions were taxable dividends and among the number of such rulings was G.M.C. 3532, C. B. VII-1, 190, in compliance with which the respondent has determined the taxability of distributions made by the West Side Lumber Company to petitioners in the instant cases.

The respondent, in support of his position and determination herein, relies on the case of Blair v. United States, 633 Ct. Cl. 193 (certiorari denied, 275 U.S. 546), upon which he also relied in the Shorb case, supra, and in which case we held that the Blair
28 case was not applicable and was distinguishable therefrom on the facts. In the Washburn and Shorb cases, supra, at the date of the distribution in the taxable years in question there were in fact no accumulated earnings or profits, no surplus from which to pay dividends and the distributions were, therefore, held to be made out of capital and did not constitute taxable income to the recipients.

In the instant cases, there was no operating deficit but, at the time the losses aggregating $404,846.99 occurred in the taxable years of 1914 and 1915, there was an undivided surplus of several million dollars mostly accumulated prior to March 1, 1913, and after which date there were accumulated earnings or profits in excess of all the dividends distributed to the stockholders prior to the $5,100,000 dividend paid April 14, 1923, of which dividend only a portion, as heretofore indicated, was determined taxable by the respondent. In the Blair case, supra, the corporation, as in the instant cases, had a surplus March 1, 1913, which was reduced by losses occuring in 1913, 1914, and 1915, creating a deficit December 31, 1915, which was overcome by earnings in 1916, 1917, and 1918, leaving a balance of accumulated earnings of the latter three years, more than sufficient to pay the dividend declared December 1918, which was held to be taxable income in the hands of the recipient stockholders.

The situation in the instant cases is similar in that the West Side Lumber Company had a surplus March 1, 1913, with losses in the two following years and earnings thereafter in the subsequent years more than sufficient to pay all dividends prior to that of April 14, 1923, of $5,100,000, and to the extent it was insufficient to pay said dividend, the amount received by petitioners was by the respondent considered exempt from income tax, being held no part of the "earnings or profits accumulated since February 28, 1913."

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber

Company on April 14, 1923, was 22.75 percent taxable instead of 28.217 percent taxable, but insists upon the application in the instant cases of the principle heretofore approved as indicated in the Shorb case, supra, and sustained in the Blair case, supra.

We are of the opinion that the deficiencies proposed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct

Judgment will be entered in each case under rule 50.

28a "The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made, and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board."

24 B.T.A. —

Filed Oct. 27, 1931

Before United States Board of Tax Appeals

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

WILLIAM R. THORSEN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 34131, 38095. Promulgated October 27, 1931

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the

extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

Edwin H. Cassels, Esq., and Andrew L. Campbell, C.P.A., for the petitioners.

Harold Allen, Esq., and Willis R. Lansford, Esq., for the respondent.

28b The Commissioner determined a deficiency in income tax for 1923 of $9,243.66 in Docket No. 34131 and of $36,720.96 in Docket No. 38095, the full amount of such deficiencies being in controversy.

These proceedings are consolidated for hearing, the issue, which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

Findings of fact

Filed Oct. 27, 1931

The petitioners are individuals, Charles J. Canfield residing and having his principal office in Chicago, Ill., and William R. Thorsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
" " 1915		$193,139.67
" 29, 1916		211,707.32
" 28, 1917	60,495.56	
" " 1918	57,901.55	
" " 1919	208,737.34	
" 29, 1930	543,490.33	
" 28, 1921	640,837.43	
" " 1922	182,954.63	
" " 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended Feb. 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

28c The difference between the profits and losses of the several years set forth is $2,050,435.93.

The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$90,000.00
" " " 29, 1920	75,000.00
" " " 28, 1921	375,000.00
" " " 28, 1922	300,000.00
September 15, 1922	150,000.00
" 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5,455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 percent taxable, instead of being 28.217 percent taxable in the case of Charles J. Canfield and 25.05 percent taxable in the case of William R. Thorsen, as formerly asserted.

28d The petitioners contend that said dividend distribution was only 14.91 percent taxable and that each reported originally more taxable income than he should have returned.

Opinion

Filed Oct. 27, 1931

SEAWELL: The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

"SEC. 201. (a) That the term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the act exempt from the tax; that the surplus so created and existing cannot be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913", which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913", as considered in O.D. 610, C.B. 3, p. 24, and A.R.M. 82,
28e C.B. 3, p. 36, and as likewise construed by the respondent and applied in the instant cases.

The respondent in making his determination excludes from consideration for the period "since February 28, 1913", the losses (except to the extent of $4,594.62, profits for the year ending February 28, 1914), sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended February 29, 1916, of $211,707.32. To March 1 1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40, from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,688.30. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,688.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000.

The difference between the $1,160,688.30 and the $5,100,000 declared and paid as dividend April 14, 1923, is $3,939,311.70 and represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as dividends in the hands of the recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen $1,111,800, and if the respondent's method of tax computation is correct, each of the petitioners is taxable on 22.75 percent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

In the year ended February 28, 1914, the company made a profit of $4,594.62, and if it had then, out of its total earnings or surplus, declared a dividend and made distribution even in excess of the $4,594.62, but less than the entire surplus, the whole dividend would have been taxable to the recipients thereof. The revenue law exempting from taxation dividends declared out of earnings accumulated prior to March 1, 1913, was not enacted until September 8, 1916. In Lynch v. Hornby, 247 U.S. 399 (decided June 3, 1918), the court said:

> We repeat that under the 1913 act dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

No dividend was declared, however, out of the earnings for the year ending February 28, 1914, and it was accordingly proper for the corporation to add that sum, $4,594.62, to its accumulated surplus, bringing it to the sum of $3,337,279.40. When in the two succeeding years there were operating losses by the corporation charged, of course, against surplus, the surplus was reduced by the sum of the losses, $404,846.99, resulting in a new surplus on February 29, 1916, of $3,932,432.41.

The treatment to be accorded this new surplus and the earnings and profits thereafter accumulated by the corporation contains the matter in controversy here. The petitioners contend that since the new surplus is less than the surplus existing at March 1, 1913, all subsequent earnings and profits of the corporation should be added to this new surplus until it equals the surplus on hand at March 1, 1913, before dividends paid to stockholders are taxable.

In other words, the petitioners contend that they are not taxable on any dividend declared and paid at any time after March 1, 1913, although the corporation has had gain in that period, if for any cause, the corporation's surplus is less than what it was on that basic date; and they urge on us the construction of the clause of the statute "earnings or profits accumulated since February 28, 1913", that a period of all the years since March 1, 1913, should be considered together to ascertain whether there have been net accumula-

tions for the whole period. It is elementary that the different parts of a statute are to be considered in pari materia. Certainly no part of a statute should be so interpreted as to annul any other part. When the statute provides that "every distribution is made * * * from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913", there is implied that some earnings or profits may belong to a class accumulated more recently than others. If all the years since March 1, 1913, are to be taken together and additions and subtractions made to ascertain if earnings or profits have "accumulated" and the amount thereof during the period, then there would
28g not seem to be much reason for ascertaining the nearness or remoteness of such earnings or profits. It could make no difference whether the distributions or dividends were from the most recent or most remote accumulations, since they all lie in one hodge-podge. Surely Congress had some reason for inserting in the statute the provision as to the most recent accumulations. All income-taking statutes under the sixteenth amendment are based on yearly periods, either calendar or fiscal years. Returns are so made out and gains and losses calculated so as to show profit or loss during the year, and for such a period it is immaterial which part of the gain is more recent or remote. It would seem singular if Congress did adopt the yearly period in taxation matters for all times and under all circumstances, except at the time of the enactment of the statute now under consideration and then only for part of the statute. It is more consonant with reason to suppose that Congress, when it provided for "accumulations since February 28, 1913", had reference to accumulations in yearly periods. A contrary interpretation of the taxing law has been sought without success. In Edwards v. Douglas, 269 U.S. 204, 217, the court said, in interpreting similar provisions of the Revenue Act of 1917, section 31 (b):

"* * * To acocmplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." * * *"

The Supreme Court in another case later said:

"* * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or loss."

Burnet v. Sanford & Brooks Co., 282 U.S. 359.

The only losses of the West Side Lumber Company were
28h for the years ending February 28, 1915, and February 29, 1916.
The petitioners, who received dividends in 1923 from the corporation, contend in effect that the losses for those two years should be carried forward and deducted from gains in the years ending February 28, 1917, 1918, 1919, and 1920. The Revenue Act of 1918, section 204, permitted a net loss in one year to be carried to the preceding year to reduce the income in that year, and if in excess of such income for the preceding year, to have such excess carried forward to the succeeding year for a similar purpose as to the income in the succeeding year. But we know of no such provision of law applicable to the years here involved, and the act of 1918 is not retroactive, or claimed by petitioners so to be. There was at the times of these losses, which aggregate $404,846.99, no operating deficit of the corporation, but an undivided surplus, as before stated, of $4,337,279.40, all of which, except $4,594.62, was accumulated prior to March 1, 1913. The undivided surplus, therefore, was adequate to take care of the operating losses in the two years mentioned, without in any way impairing the capital of the corporation, which amounted to $1,500,000.

The petitioners cite two recent court decisions which they insist sustain their contentions, viz, Leland v. Commissioner, 50 Fed. (2d) 523, and Hadden v. Commissioner, 49 Fed. (2d) 709. In the Leland case, first cited, the Board of Tax Appeals, 18 B.T.A. 795, is affirmed. In the opinion of the court it is said:

"Then again, as the Leland-Gifford Company had on hand, at the time the distributions were made, earnings or profits that had accumulated since 1913, we do not think that the provisions of section 201 (c) of the Revenue Act of 1921 and 1924 are applicable."

This case does not appear to be an authority for the petitioner. In the case of Hadden v. Commissioner, supra, the corporation never had a surplus, but operating losses from its organization in 1904, in each year until April 30, 1917, at which time the net deficit was $833,862.92. The total losses between March 1, 1913, and April 30, 1917, were $329,549.22. From April 30, 1917, to December 20, 1917, by the sale of capital assets, it had a taxable profit of $405,949.07. The court held that the operating losses or carrying charges after March 1, 1913, should be deducted from the profits of December 20, 1917, before dividends declared and paid out of such taxable profits were taxable to the stockholders receiving the dividends.

What the court would have held if, as in the case at bar, the
28i corporation had had accumulated surplus and undivided profits sufficient to have absorbed all the losses before the profits by sale of the capital assets were realized, it is mere speculation to surmise; but the facts in that case are so different in material respects from those in the instant case that we do not feel impelled to follow certain of the language used by the learned judge

who delivered the opinion, even though it might be broad enough to include a situation comparable to that before us.

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 28.217 per cent taxable, but insists upon the application in the instant cases of the principle adopted and maintained for many years by the Bureau of Internal Revenue and set forth in G.C.M. 3532, C.B. VII-1, 190, which position we think correct and we so expressed ourselves in Louise Glassell Shorb, 22 B.T.A. 644, 645, in which case the Commissioner had taken an opposite view. We are of the opinion that the principle so approved is also sustained in *Blair* v. *United States*, 63 Ct. Cls. 193; certiorari denied 275 U. S. 546.

We are of the opinion that the deficiencies proposed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct.

Reviewed by the Board.

Judgment will be entered in each case under rule 50.

Dissenting opinion

TRAMMELL, dissenting: It seems to me too clear for controversy that any surplus existing at February 28, 1913, has no connection whatever with what the accumulated surplus since that date is. What the majority opinion holds might be illustrated as follows: If a taxpayer had an earned surplus of $10,000 on February 28, 1913, and subsequent to that date had earnings in some years, and losses in others, and at the end of 1920 the total losses since February 28, 1913, equaled its total earnings since that date, with the result that at that time there were no earnings in fact accumulated since 1913, a distribution at the close of 1920 would be held to be out of the earnings or profits accumulated since February 28, 1913. In other words, the losses since February 28, 1913, are applied against the surplus existing on that date. Yet in the illustration given
28j it is perfectly plain that the only surplus to be distributed was that existing on February 28, 1913. This, in my opinion, results in taxing the surplus existing on February 28, 1913, when distributed in dividends, contrary to the statute. In my opinion there can be no accumulated surplus since February 28, 1913, unless the earnings since that date exceed the losses since that date. These are the only factors to be considered. I see no occasion to apply losses since 1913 to surplus at that time in order to ascertain the accumulated earnings since February 28, 1913. This is quite different from the principle of determining earned surplus for invested capital purposes, where there is no requirement to determine accumulated surplus since a certain date, but only the question as to the total earned surplus existing in the taxable year or on hand

when that year began. See *Willcuts* v. *Milton Dairy Co.*, 275 U. S. 215. I believe the statute should be construed according to its plain language, that is, the distribution to be taxable must be out of earnings or profits accumulated since February 28, 1913, and that such amount should not be affected in any way by any surplus existing at that time.

The losses since February 28, 1913, should be taken from the profits since that date to determine the accumulated profits since that date.

I do not thing the *Shorb* case in 22 B.T.A. 644, is authority for the majority decision. The corporation in that case was not organized until after March 1, 1913.

The prevailing opinion also relies on the case of *Blair* v. *United States*, 63 Ct. Cls. 193 (A.F.T.R. 6552). In the case of *J. L. Washburn*, 16 B.T.A. 1091, the Board pointed out that it considered the *Blair* case to be unsound and declined to follow it.

In the case of *Hadden* v. *Commissioner*, 49 Fed. (2d) 709 (A.F.T.R., vol. 9, 1497), the Circuit Court of Appeals for the Second Circuit, said:

"The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *."

I think this view is correct and that it is erroneous to reduce the surplus on hand on February 28, 1913, by subsequent losses to determine the earnings and profits accumulated since that date.

MORRIS, MARQUETTE, SMITH, STERNHAGEN, LOVE, and MCMAHON agree with this dissent.

28k [Clerk's Certificate to foregoing paper omitted in printing.] (pp. 28a to 28k inserted per order of June 15, 1932.)

29 United States Board of Tax Appeals, Washington

Docket No. 34131

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Entered Dec. 12, 1931

Pursuant to the findings of fact and opinion of the Board promulgated October 27, 1931, the respondent on November 23, 1931, filed notice of settlement under rule 50. Copy of said notice having been served on the petitioner and the petitioner on December 16, 1931, having filed notice of acquiescence to the proposed settlement, it is

Ordered and decided: That there is a deficiency in tax for the year 1923 in the amount of $5,145.19.

Enter:

(Signed) M. F. SEAWELL,
Member.

A True Copy:
Teste:
[SEAL]

B. D. GAMBLE,
Clerk U.S. Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review

Filed Feb. 1, 1932

Comes now Charles J. Canfield, by Edwin H. Cassels and Barry Gilbert, his attorneys, and respectfully shows unto this court that:

A

1. The petitioner is a citizen of the United States and of the State of Illinois, with his residence in Chicago, Cook County, Illinois.

2. On or about the 14th day of March 1924, the petitioner
30 filed in the office of the collector of internal revenue at Chicago, Illinois, his detailed income tax return for the calendar year 1923 and reported therein a net taxable income of $140,656.86 for said year 1923. Included in such return was an item of $33,360, returned as taxable income from a certain dividend received by him on or about April 14, 1923, from West Side Lumber Company, a California corporation.

3. The petitioner also reported in his said 1923 return certain other dividends received from West Side Lumber Company on or about February 12, 1923, amounting to $6,000. There is no dispute with respect to the correctness of such return as to said dividend of February 12, 1923.

4. West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares, having a par value of $100 each. The petitioner during all of such period owned 600 shares of said capital stock.

5. In addition to its said original capital of $1,500,000, West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78 and the book value of its common stock was on that date $388.85 per share.

6. On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913, so that the book value of the common stock on April 14, 1923, was $439.54 per share.

7. The earnings and losses of the company after March 1, 1913, were as follows:

Year ending	Profits	Losses
February 28, 1914	$4,594.62	
" 28, 1915		$193,139.67
" 29, 1916		211,707.32
" 28, 1917	60,495.56	
" 28, 1918	57,901.55	
" 28, 1919	208,737.34	
" 29, 1920	543,490.33	
" 28, 1921	640,837.32	
" 28, 1922	182,954.63	
" 28, 1923	718,858.29	
March 1, 1923 to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
Total	$2,455,282.92	$404,846.99

31 The difference between the profits and losses of the several years set forth is $2,050,435.93.

8. The following dividends were paid by West Side Lumber Company after February 28, 1913:

Period	Per share	Amount
Year ended Feb. 28, 1918	$6	$90,000.00
Year ending Feb. 29, 1920	5	75,000.00
Year ended Feb. 28, 1921	25	375,000.00
Year ended Feb. 28, 1922	20	300,000.00
September 15, 1922	10	150,000.00
September 18, 1922	10	150,000.00
February 12, 1923	10	150,000.00
		$1,290,000.00

9. On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock. The petitioner received from this source from his said 600 shares the sum of $204,000. The issues in this case concern the taxable income due from the said Charles J. Canfield with respect to this payment received by him.

10. The Commissioner of Internal Revenue, by his letter dated August 25, 1927, addressed to the petitioner, found that of the said $5,100,000 paid by the said dividend of West Side Lumber Company of April 14, 1923, $3,579,720.71 was paid out of surplus earned prior to March 1, 1913, and that the balance thereof, or $1,520,279.29, was paid out of the earnings of such company accumulated after February 28, 1913. This latter amount is 29.81% of the dividend paid on April 14, 1923. The Commissioner in such letter declared that such 29.81% of the dividend of April 14, 1923, represented taxable income to the petitioner under the provisions of section 201 of the Internal Revenue Act of 1921.

11. Thereafter, on November 25, 1927, the Commissioner of Internal Revenue issued and mailed to the petitioner a deficiency letter from which the appeal to the Board of Tax Appeals hereinafter mentioned was prosecuted, and therein determined that the earnings accumulated after February 28, 1913, by West Side Lumber Com-

pany were $1,439,079.29, or 28.217% of the dividend paid on April 14, 1923, and that the petitioner was therefore taxable under the provisions of section 201 of the Internal Revenue Act of 1921

32 upon 28.21% of the dividend of $340 per share, or $57,562.68, received with respect to his said 600 shares.

12. In his said income-tax return for the said calendar year of 1923 the petitioner had reported as taxable income the amount of $55.60 per share under his interpretation of section 201 of said Internal Revenue Act of 1921. The said sum of $57,562.68 arrived at by the said Commissioner amounted to $95.9378 per share. The issues thus presented between the Commissioner and this petitioner as a result of said deficiency letter were as to whether or not the difference between these two sums per share, on each of said 600 shares, or $40.3378 per share, constituted taxable income to the petitioner for the year 1923.

13. Thereafter, the petitioner appealed from said determination of said Commissioner to the United States Board of Tax Appeals (Docket No. 34131). The said Commissioner duly appeared therein and filed a stipulation that his prior computations set forth in said letters of August 25, 1927, and November 25, 1927, were incorrect and that the said dividend of $340 per share paid by West Side Lumber Company on April 14, 1923, to this petitioner, with respect to each of his said 600 shares, was not to exceed 22.75% taxable, or at the rate of $77.35 per share or a total of $46.410.

14. Thereafter, the appeal of the petitioner was duly heard by said Board of Tax Appeals, which, on, to wit, the 27th day of October, 1931, promulgated its findings of fact and opinion in said proceeding and therein found and gave its opinion (eight members of said Board concurring therein and seven members of said Board dissenting therefrom) that said dividend of $340 per share paid by West Side Lumber Company to this petitioner on April 14, 1923, with respect to each of his said 600 shares was 22.75% taxable.

15. The Board ordered that judgment be entered in said case under rule 50 of said Board of Tax Appeals and pursuant thereto an order was subsequently entered finding that the total tax due from this petitioner for said year 1923 was $42,367.76, of which $37,222.57 had been previously assessed, leaving a balance of $5,145.19 for which judgment was entered by said Board under said rule 50.

16. This petitioner claims that:

(a) This case is governed by section 201 of the Internal Revenue Act of 1921.

(b) West Side Lumber Company was entitled thereunder

33 to distribute tax free all earnings and profits accumulated or increase in value in property accrued prior to March 1, 1913. Such earnings or profits were a sum equivalent to its surplus on February 28, 1913, namely, $4.332,684.78, and this sum was therefore distributable exempt from tax.

(c) The "earnings and profits" of West Side Lumber Company for the period March 1, 1913, to April 14, 1923, inclusive, were the difference between the total profits of the parts of such period in which profits were made ($2,455,282.92), and the total losses for the parts of such period in which losses were sustained ($404,846.99),

namely, $2,050,435.93. These net earnings so computed were the "earnings and profits" of West Side Lumber Company "accumulated since February 28, 1913," within the meaning of section 201 of the Internal Revenue Act of 1921.

(d) $1,290,000 of this amount having been distributed as dividends prior to April 14, 1923, the remainder of such amount, or $760,435.93, was distributed by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share, and having been "accumulated since February 28, 1913", was taxable income to the several recipients thereof to the extent received by each.

(e) This sum of $760,435.93 was 14.91% of the total distribution of $5,100,000 ($340 per share) made April 14, 1923, by West Side Lumber Company, and therefore such distribution of $340 per share was 14.91%, or $50.694 per share, taxable to the several recipients within the meaning of section 201 of the Internal Revenue Act of 1921.

(f) The "earnings and profits accumulated since February 28, 1913", having been thus distributed, the balance of the distribution made by the dividend of $340 per share on April 14, 1923, was free from tax in the hands of the recipients thereof under the provisions of section 201 of the Internal Revenue Act of 1921.

(g) The taxable portion of the dividend of April 14, 1923, received by the petitioner from West Side Lumber Company was only 14.91% thereof, or approximately $30,416, which is $2,944 less than was actually returned by him in his income tax return for 1923.

(h) There was no deficiency of tax as to 1923 on the part of your petitioner.

17. The facts upon which the petitioner relies are those facts that are set out in extenso in the findings of fact of said Board of Tax Appeals promulgated on October 27, 1931, which are hereby by
34 reference incorporated in and made a part of this petition with as full force and effect as though set forth in haec verba herein. The statements hereinbefore made are also relied upon and are in form a restatement of the findings of fact of the Board of Tax Appeals.

18. Briefly, the nature of this controversy is the question as to the meaning of section 201 of the Internal Revenue Act of 1921 and in particular as to whether or not losses sustained in specific years following February 28, 1913, are to be deducted from profits gained in other years of such periods since February 28, 1931, in determining the "earnings and profits accumulated since February 28, 1913."

B

The petitioner hereby assigns the following errors with respect to the decision of said Board of Tax Appeals:

1. That said Board erred in finding that the dividend paid by West Side Lumber Company on April 14, 1923, was 22.75% taxable upon the 600 shares of its capital stock held by the petitioner, under the provisions of section 201 of the Revenue Act of 1921.

2. That said Board erred in not finding that the dividend paid by West Side Lumber Company on April 14, 1923, was only 14.91% taxable upon the 600 shares of its capital stock held by the petitioner, under the provisions of section 201 of the Revenue Act of 1921.

3. That said Board erred in failing to deduct the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

4. That said Board erred in so interpreting section 201 of the Internal Revenue Act of 1921 as to require the exclusion of the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

5. That said Board erred in not finding that the entire surplus of West Side Lumber Company of $4,332,684.78 on March 1, 1913, was distributable by it to its stockholders without tax to such stockholders.

6. That said Board erred in finding that only 77.25% of the
35 dividend paid by West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913.

7. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year of 1923 all of his taxable income for that year.

8. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year 1923, $2,944 more of taxable income than was actually received by him for that year.

9. That said Board erred in not finding that the total earnings and profits of West Side Lumber Company accumulated since February 28, 1913, within the meaning of section 201 of the Internal Revenue Act of 1921 were $2,050,435.93.

10. That said Board erred in not finding that only $760,435.93 of the distribution made by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share was accumulated since February 28, 1913, and taxable as income to the several recipients thereof.

Wherefore, this petition respectfully prays that the said decision and order of the Board of Tax Appeals may be reviewed by the Circuit Court of Appeals for the Seventh Circuit as by statute provided, and that the said decision and order of the Board of Tax Appeals be reversed with a finding that there is no deficiency in the tax of the petitioner for the year 1923.

CHARLES J. CANFIELD,
By EDWIN H. CASSELS,
BARRY GILBERT,
His Attorneys.

[*Duly sworn to by Charles J. Canfield, jurat omitted in printing.*]

36 Before U. S. Board of Tax Appeals

Praecipe for record

Filed Feb. 8, 1932

To the Clerk of the Board of Tax Appeals:

You will please prepare the record in the above-entitled proceeding, which is an appeal from a decision of the Board of Tax Appeals promulgated October 27, 1931, in the proceeding entitled "Charles J. Canfield, petitioner, vs. Commissioner of Internal Revenue, respondent, docket 34131", and transmit and deliver to the clerk of the United States Circuit Court of Appeals for the Seventh Circuit, sitting at Chicago, Illinois, duly certified copies of the following documents:

1. All docket entries of proceedings before the Board of Tax Appeals in said proceeding.
2. Pleadings therein before the Board of Tax Appeals.
3. Findings of fact, opinion and decision therein of the Board of Tax Appeals.
4. Petition for review of said decision.
5. The stipulation of facts entered into by the petitioner and the respondent in said proceeding.

Respectfully,

EDWIN H. CASSELS,
BARRY GILBERT,
Attorneys for Charles J. Canfield.

37 [Clerks' certificates to transcript omitted in printing.]

38 [Caption omitted.]
[Appearances of counsel omitted in printing.]

39 IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4761

CHARLES J. CANFIELD, PETITIONER

vs.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Stipulation as to entry of order

Filed June 15, 1932

It is hereby stipulated and agreed by and between the parties hereto that the following order may, with the approval of the Circuit Court of Appeals, be entered in the foregoing cause:

40 "It is ordered and decreed (1) that the report of the Board of Tax Appeals promulgated October 27, 1931, including findings of fact, opinion, and dissenting opinion and concurrence with such dissent, therein contained, is hereby made a part of the record in this cause, and the clerk of this court is hereby directed to print the same in the Transcript of Record; (2) the clerk of this court be directed to print in said transcript the following statement:

"'The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board', and (3) the clerk is hereby directed to omit from the transcript the 'additional praecipe' filed on April 30, 1932, in the Board of Tax Appeals."

EDWIN H. CASSELS and BARRY GILBERT,
Solicitors for Petitioner.
C. M. CHAREST, *Solicitor for Respondent.*

[File endorsement omitted.]

41 IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted.]

Order readdition to record

June 15, 1932

It is ordered and decreed (1) that the report of the Board of Tax Appeals promulgated October 27, 1931, including findings of fact, opinion and dissenting opinion and concurrence with such dissent, therein contained, is hereby made a part of the record in this cause, and the clerk of this court is hereby directed to print the same in the Transcript of Record; (2) the clerk of this court be directed to print in said transcript the following statement:

"'The report printed herein on pages 21 to 28, inclusive, was a divisional report of the Board of Tax Appeals and an order was entered on June 29, 1931, for the review of such report by the Board as a whole. Such review was made and the report, findings of fact, opinion, and dissenting opinion printed in this transcript on the pages following page 28 and prior to page 29 was thereafter issued as the final report and opinion of such Board', and (3) the clerk is hereby directed to omit from the transcript the 'additional praecipe' filed on April 30, 1932 in the Board of Tax Appeals."

42 [Appearances of counsel omitted in printing.]

43 IN UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted.]

Order setting cause

October 4, 1932

It is ordered by the court that this cause be, and the same is hereby, set down for hearing on November 9, 1932.

44 [Minute entry of argument and submission, November 9, 1932, omitted in printing.]

45 IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4761. October term, 1932, January session, 1933

CHARLES J. CANFIELD, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review of decision of the United States Board of Tax Appeals

Opinion

Filed January 13, 1933

Before ALSCHULER, EVANS, and SPARKS, Circuit Judges.

By this proceeding petitioner seeks to review a decision of the United States Board of Tax Appeals wherein he is charged with a deficiency as to his income taxes for the year 1923 in the sum of $9,243.66. Petitioner denies any deficiency, and claims that he reported in his original return, and paid tax upon, more taxable income than he had received in that year.

The controversy arises out of the declaration of a dividend, on April 14, 1923, by West Side Lumber Company, hereinafter referred to as the company, in the aggregate sum of $5,100,000. The specific question for determination is, What part of that dividend is chargeable to the earnings and profits of the company accumulated since March 1, 1913, and what part is chargeable to the surplus of the company which existed immediately prior to March 1, 1913? Under the law herein involved that part of the dividend properly chargeable to the earnings covered by the period first referred to are taxable, and the remaining portion of the dividend is not taxable.

The facts out of which the controversy arises were stipulated and are as follows:

46 Petitioner resides and has his principal office in Chicago, Illinois. West Side Lumber Company is a California corporation. From March 1, 1913, to April 14, 1923, inclusive, its capital stock consisted of 15,000 shares having a par value of $100, of which petitioner owned 600 shares. On March 1, 1913, the company had a surplus of $4,332,684.78. On April 14, 1923, its surplus had been increased by earnings and profits in the sum of $760,435.93, and at that time its consolidated surplus was $5,109,443.75, which included earnings of a subsidiary company in the sum of $16,323.04.

The earnings and losses of the company after March 1, 1913, were as follows:

Year ended	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	646,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54 total for year ended Feb. 29, 1924)	37,413.17	
	2,455,282.92	404,846.99

leaving a net profit for those years of $2,050,435.93.

The following dividends were paid by the company after March 1, 1913:

Year ended February 28, 1918	$90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00
September 18, 1922	150,000.00
February 12, 1923	150,000.00
Total	1,299,000.00

On April 14, 1923, the company declared a dividend of $5,100,000, or $340 for each share of its stock, of which amount petitioner received $204,000.

47 On March 14, 1924, petitioner filed his income-tax return for the calendar year 1923 and reported a net taxable income of $140,656.86. Included in his gross income of that return was an item of $6,000 as taxable income from the dividend received by him on February 12, 1923, as shown above; and likewise included was another item in the amount of $33,360 returned as dividend received on April 14, 1923.

Upon the facts stated the Commissioner concluded that 22.75 percent of the dividend declared on April 14, 1923, to wit, $1,160,688.30, is taxable. The Commissioner arrived at this conclusion by deducting the total dividends declared from February 28, 1918, to February 12, 1923, inclusive, aggregating $1,290,000, from the total

earnings and profits from and including the year 1917 to and including April 14, 1923, aggregating $2,450,688.30. The result of that subtraction is $1,160,688.30, and the Commissioner contends that it truly reflects the accumulated earnings and profits of the company since March 1, 1913. He adds the profits for the year 1914, which amount to $4,594.62, to the surplus of March 1, 1913, and deducts therefrom the losses for 1914 and 1915, which aggregate $404,846.99, thereby reducing the surplus of March 1, 1913, to $3,932,432.41.

The Board of Tax Appeals sustained the findings of the Commissioner, and petitioner challenges the Board's action in that respect.

SPARKS, Circuit Judge: The determination of the question presented calls for the construction of section 201 (a) and (b) of the Revenue Act of 1921, c. 136, 42 Stat. 227. So far as applicable they read as follows:

"(a) That the term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, * * *.

"(b) For the purposes of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *"

48 When the dividend of $5,100,000 was declared by the company on April 14, 1923, it included all the company's accumulated profits and earnings since March 1, 1913, and also most, if not all, of its surplus which existed on March 1, 1913. The statute referred to does not prevent the declaration of a dividend out of that surplus provided there are no undivided profits or earnings left which were accumulate since March 1, 1913. Those undivided profits and earnings must be consumed first, and every distribution of them by way of dividend must be from those most recently accumulated. Up to this point the parties are not at variance, but they differ as to the proper method of determining the amount of earnings and profits accumulated since February 28, 1913.

It is contended by petitioner that the company's accumulated earnings and profits from March 1, 1913, to April 14, 1923, can be ascertained only by deducting the losses for 1914 and 1915, which amount to $404,846.99, from the total earnings and profits of the other years of that period, which aggregate $2,455,282.92. In other words, he contends that the accumulated earnings and profits of the company, within the meaning of the statute as applied to the company, is the difference between the surplus on March 1, 1913, and the surplus on April 14, 1923.

With petitioner's contention we are in accord, and we are convinced that this view is consonant with the intention of Congress as expressed in the language of the statute above referred to.

By reason of the fact that section 201 (b), supra, provides that dividends are presumed to have been made from the most recently accumulated earnings or profits, respondent argues that losses sustained after March 1, 1913, reduce previously accumulated earnings, and may not be treated as suspended to absorb the accumulated earnings of subsequent years. With this contention we cannot agree. If we were here concerned in determining earned surplus for invested capital purposes at a designated date, or if the company were a party to this proceeding and was seeking credit for losses accruing in 1914 and 1915 as against profits in subsequent years respondent's argument might be both pertinent and plausible; but we are required to determine the company's accumulated surplus since March 1, 1913, unaffected, as we see it, by its surplus which existed on that date. In order to arrive at the result as contemplated by the plain words of the statute we think the losses sustained since March 1, 1913,
49 should be deducted from the earnings and profits since that date.

No case has been called to our attention in which the facts are in all respects similar to the facts herein presented. In Hadden v. Commissioner, 49 F. (2d) 709, the court was called upon to determine, under the same statute which we are now considering, the proper method of arriving at the correct amount of profits of a corporation which had accumulated since March 1, 1913. There was no accumulated surplus on that date, but, on the other hand, there was quite a large deficit, which grew each year until in September 1917, when the corporation made a very large profit upon the sale of some of its coal land. The court said:

"No earned surplus can be accumulated until the deficit or impairment of paid-in capital has been made good. Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part. Operating losses sustained after March 1, 1913, must be deducted from profits realized after that date before they can be a taxable profit on the sale of the land, and the accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *."

We are in accord with the rule thus announced, and we think it makes no difference whether or not there be a surplus existing on March 1, 1913. Such construction we do not regard as in any way violating that part of the statute which provides that dividends shall be paid out of the most recently accumulated earnings.

It may or may not be true in the instant case that the losses of 1914 and 1915 were actually paid out of the March 1, 1913, surplus. If

they were thus paid, it can make no difference, because the surplus which then existed, for the purposes of the act, must be considered as capital, and if impaired may be replaced before any tax computation. Southern Pacific Co. v. Lowe, 247 U.S. 330; Lucas v. Alexander, 279 U.S. 573; Old Colony R. Co. v. Commissioner, 284 U.S. 552.

We do not regard the last cited cases as holding that surplus earnings as of March 1, 1913, must in every respect be treated as
50 other capital, or that it is actually capital in the sense that it must be replaced if impaired. But for the purposes of the act it may be replaced if the corporation so desires, and it may deduct that amount from subsequent earnings; and it may, on the other hand, distribute that surplus as dividends without replacement, provided there are no remaining profits or earnings left undisturbed which were accumulated since March 1, 1913.

Under the facts presented there was no deficiency in petitioner's income tax for 1923, and he is entitled to a refund of taxes paid by him for that year, computed on the basis that the distribution of April 14, 1923, was only 14.91 per cent taxable.

The order of the Board is reversed, and the cause remanded for further proceedings not inconsistent with this opinion.

51 In United States Circuit Court of Appeals

4761

CHARLES J. CANFIELD

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for review of order of the United States Board of Tax Appeals

Judgment

Jan. 13, 1933

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on December 21, 1931, by the United States Board of Tax Appeals be, and the same is hereby, reversed; and that this cause be, and the same is hereby, remanded to the said United States Board of Tax Appeals for further proceedings not inconsistent with the opinion of this court.

Recital as to issuance of mandate

And afterwards, to wit: On the third day of February 1933 the mandate of this court issued to the United States Board of Tax Appeals.

52 In United States Circuit Court of Appeals for the Seventh Circuit

[Title omitted.]

Motion to recall and stay mandate

Filed Feb. 28, 1933

And now comes the Commissioner of Internal Revenue, respondent in the above-entitled cause, by John P. Barnes, special attorney, Bureau of Internal Revenue, his attorney, and moves the court for entry of an order recalling its mandate, and as grounds for this motion states that the filing with the Supreme Court of the United States of a petition for a writ of certiorari is being considered by the Solicitor General of the United States, and that such petition will probably be filed.

JOHN P. BARNES,
Special Attorney, Bureau of Internal Revenue,
Attorney for Respondent.

[File endorsement omitted.]

53 In United States Circuit Court of Appeals

[Title omitted.]

Order recalling and staying mandate

Feb. 28, 1933

Now this day comes counsel for respondent and presents a motion for recalling and staying the mandate of this court, pending a petition to the Supreme Court of the United States for a writ of certiorari.

On consideration whereof: It is now here ordered that the mandate in this cause be, and the same is hereby, recalled and stayed until the further order of this court.

It is further ordered that counsel for respondent proceed with diligence and promptly file the petition for a writ of certiorari in the Supreme Court of the United States and, upon the filing of said petition file in this court proof of the filing of said petition in said court.

54 [Clerk's certificate to foregoing transcript omitted in printing.]

58 In Supreme Court of the United States

Order extending time within which to apply for writ of certiorari

Filed April 11, 1933

On consideration of the motion of counsel for the petitioner in the above-entitled cause, and good cause therefor having been shown, it is now here ordered that the time within which a petition for a writ of certiorari may be filed herein be, and the same hereby is, extended for a period of sixty days from this date.

Dated this eleventh day of April 1933.

WILLIS VAN DEVANTER,
Associate Justice of the Supreme Court of the United States.

[File endorsement omitted.]

59 SUPREME COURT OF THE UNITED STATES

Order allowing certiorari

Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

60 (Endorsement on cover:) File No. 37,761. U.S. Circuit Court of Appeals, Seventh Circuit. Term No. 158. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Charles J. Canfield. Petition for a writ of certiorari and exhibit thereto. Filed June 10, 1933. File No. 158 O.T. 1933.

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CHARLES J. CANFIELD

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above cause on January 13, 1933, reversing a decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 28a–28j) is reported in 24 B.T.A. 480. The opinion of the Circuit Court of Appeals (R. 42) is reported in 62 F. (2d) 751.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933 (R. 46). By order of this Court dated April 11, 1933, the time within which petition might be filed was extended to and including June 10, 1933 (R. 49). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, for the purpose of fixing the taxable status of a dividend declared and paid in 1923, losses incurred in 1915 and 1916 should be used to reduce the 1913 surplus or the profits accumulated from 1917 to 1923.

STATUTE INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 228:

> SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.

(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of (1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

STATEMENT

Charles J. Canfield was, at all times here material, a stockholder in the West Side Lumber Company, a California corporation, holding 600 of its total issue of 15,000 shares, having a par value of $100 each (R. 28b).

The West Side Lumber Company had a surplus of $4,332,684.78 on March 1, 1913, which was increased to $5,093,120.71 by April 14, 1923, when the dividend in question was declared. The company

realized a small profit during the year ended February 28, 1914; sustained large losses in the years ended February 28, 1915 and February 29, 1916, and realized substantial profits in the succeeding years to and including the fractional period ended April 14, 1923. (R. 28b.) Dividends were declared from 1918 to 1923 aggregating $1,291,000. On April 14, 1923, the company declared and paid a dividend of $5,100,000, or $340 per share, of which the respondent received $204,000. (R. 28c.)

The Commissioner of Internal Revenue contended before the Board of Tax Appeals that this dividend was 22.75 percent taxable while the respondent alleged it to be only 14.91 percent taxable (R. 28c–28d). The difference depends upon the proper application of the losses sustained in 1915 and 1916. These losses were treated by the petitioner as reducing preexisting surplus while the respondent asserted they should be deducted from the income subsequently earned for the purpose of ascertaining the most recently accumulated earnings or profits subject to tax. The majority of the Board of Tax Appeals sustained the ruling of the Commissioner (R. 28d–28i). The Circuit Court of Appeals reversed (R. 46).

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the most recently accumulated earnings or profits subject to tax as dividends in the hands of stockholders are limited to the *net* profits realized

throughout the entire period intermediate February 28, 1913, and the date of dividend distribution.

2. The Circuit Court of Appeals erred in holding that corporate surplus existing as of March 1, 1913, must be considered as capital and if impaired may be replaced notwithstanding it has actually been risked and in part lost in the conduct of the business prior to the dividend distribution.

3. The Circuit Court of Appeals erred in failing to approve the method employed by the Commissioner of Internal Revenue whereby the taxable status of corporate distributions is fixed by first applying the profits realized in the period immediately preceding the dividend followed by those of the prior years in inverse order to March 1, 1913, with allowance for dividends earlier paid, treating each year as a separate unit.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below presents a direct conflict with that of the Circuit Court of Appeals for the Ninth Circuit in *William R. Thorsen* v. *Commissioner,* decided May 19, 1933, not yet reported. The *Thorsen case* involved another stockholder of the same corporation and the two cases were consolidated for hearing and decision before the Board of Tax Appeals. The decision of the Board was affirmed in the *Thorsen case* and reversed in the instant case.

The decision of the court below is believed to be in conflict with that of the Court of Claims in *Blair* v. *United States,* 63 C.Cls. 193, certiorari denied, 275 U.S. 546. There is much of analogy in the fiscal experience of the corporations involved in the *Blair case* and the present case. There, as here, there was a surplus on March 1, 1913. This was followed by losses in 1914 and 1915 and gains in 1916, 1917, and 1918. The dividend was declared and paid in 1918. The taxpayer was held properly taxable upon the full amount of the distribution received by him. The court below made no reference to the *Blair case,* although it was cited in the majority opinion of the Board of Tax Appeals and relied upon by the petitioner.

2. The decision of the court below is believed to be unsound. There is nothing inherent in the nature of corporate dividends which renders them immune to taxation. As gain derived from capital, they are within the spirit as well as the letter of the statutory definition of gross income. Whatever of exemption exists springs from the language of the statute (*Lynch* v. *Hornby,* 247 U.S. 339), the material portion of which reads (Section 201 (b), *supra*):

> * * * any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax, * * *.

Clearly the situation calls for the rule announced by this Court that in favor of exemption nothing

is to be taken lightly as by inference or presumption. *Bank* v. *Tennessee,* 104 U.S. 493, 495; *Bank of Commerce* v. *Tennessee,* 161 U.S. 134, 146; *Cornell* v. *Coyne,* 192 U.S. 418, 431; *Morris Canal Co.* v. *Baird,* 239 U.S. 126.

The decision below necessarily ignores the accepted principles of accounting and the actualities of the situation. Practically, as well as from a bookkeeping standpoint, there is no such thing as a coexisting surplus and an operating deficit. When the company sustained large losses in 1915 and 1916 it made them good from its preexisting surplus. The losses of 1915 and 1916 could not be suspended until profits should be realized in later years, if ever. Neither is there any basis for assuming that earned surplus existing on March 1, 1913, is invested with the attributes of capital for all purposes so that it may be replaced if impaired although it has in fact been risked and in part lost in the conduct of the business. Such a contention was advanced and rejected by the court in the *Thorsen case* after careful analysis of several cognate decisions of this Court. The position adopted by the court below would necessarily permit income earned *any* number of years after March 1, 1913, to be treated as profits accumulated before March 1, 1913. Such a result might possibly be justified where required by the express mandate of an unambiguous statute; certainly it should not be sanctioned where predicated upon a strained construction of a doubtful statute.

The decision of the Circuit Court of Appeals runs counter to the settled and consistent administrative interpretation of the statute.[1] With this construction before it the Congress has repeatedly reenacted the substance of the statute without material change.[2] The case is clearly one of legislative recognition and approval of a fixed administrative construction. *National Lead Co.* v. *United States*, 252 U.S. 140; *Brewster* v. *Gage*, 280 U.S. 327, 336; *Murphy Oil Co.* v. *Burnet*, 287 U.S. 299, 302–303. A mistaken interpretation would, it is reasonable to assume, have been corrected specifically in the later revisions of the statute. *Heiner* v. *Colonial Trust Co.*, 275 U.S. 232, 235; *Massachusetts Mutual Life Ins. Co.* v. *United States*, 288 U.S. 269, 273.

3. The question is one of importance in the administration of the revenue laws. It arises under all the taxing Acts. The Bureau of Internal Revenue informs us that there are now pending a large number of cases the disposition of which depends upon the correct answer to the question here involved. The Bureau estimates upon the basis of data which is admittedly incomplete that the deter-

[1] A.R.M. 82, 3 Cumulative Bulletin 36 (1920); G.C.M. 3532, VII–1 Cumulative Bulletin 190, 191–193 (1928).

[2] Section 201 (a) and (b), Revenue Acts of 1924, c. 234, 43 Stat. 253, 254 (U.S.C., Title 26, Sec. 932), and 1926, c. 27, 44 Stat. 9, 10 (U.S.C.App., Title 26, Sec. 932); Section 115 (a) and (b), Revenue Acts of 1928, c. 852, 45 Stat. 791, 822, and 1932, c. 209, 47 Stat. 169, 203 (U.S.C.Sup. VI, Title 26, Sec. 115).

mination of this question will directly affect the revenue upon approximately $20,000,000 per year, currently and for some years to come.

Wherefore it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

JUNE 1933.

U. S. GOVERNMENT PRINTING OFFICE: 1933

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 158

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CHARLES J. CANFIELD

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 38–42) is reported in 62 F. (2d) 751. The opinion of the Board of Tax Appeals (R. 24–30) is reported in 24 B.T.A. 480.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1933. (R. 42.) By order of this Court dated April 11, 1933, the time within which a petition for a writ of certiorari might be filed was extended to and including June 10, 1933.

(R. 44.) The petition was filed June 10, 1933, and was granted October 9, 1933. (R. 44.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining what part of a distribution declared and paid by a corporation to its stockholders in 1923 represented earnings or profits accumulated prior to March 1, 1913, and was therefore exempt from tax, losses sustained by the corporation in 1915 and 1916 are to be regarded as diminishing the surplus existing on March 1, 1913, or as reducing the profits accumulated between 1916 and 1923.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 21–22.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 23–24) may be summarized as follows:

In 1923, the year in question, the respondent owned 600 of the 15,000 shares comprising the capital stock of the West Side Lumber Company, a California corporation. The par value of each share was $100. (R. 23.)

On March 1, 1913, the company had a surplus of $4,332,684.78, in addition to its original capital of $1,500,000. In the succeeding years, up to April

14, 1923, its earnings and losses were as follows (R. 23):

Year ended—	Profits	Losses
February 28, 1914	$4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
Total	2,455,282.92	404,846.99

Dividends were declared from 1918 to 1923 aggregating $1,290,000. (R. 24.)

On April 14, 1923, the surplus was $5,093,120.71. (R. 23.) On that day, the company declared a dividend of $5,100,000, or $340 per share, of which the respondent received $204,000. (R. 24.)

The Commissioner of Internal Revenue contended before the Board of Tax Appeals that of this dividend 22.75 percent was taxable, as being paid out of earnings accumulated since February 28, 1913, while respondent claimed that only 14.91 percent of it was so taxable. (R. 24.) The difference depends upon the proper application of the losses sustained in 1915 and 1916.[1] These

[1] Throughout the brief, references to taxable years mean the taxpayer's fiscal years ending on February 28th or 29th of the years named, i.e., by losses in 1916, is meant the loss sustained during the year ending February 29, 1916.

losses were treated by petitioner as reducing pre-existing surplus, while the respondent asserted they should be deducted from the income subsequently earned for the purpose of ascertaining the most recently accumulated earnings or profits subject to tax.

The Board of Tax Appeals (seven members dissenting) sustained the ruling of the Commissioner. (R. 24–30.) The Circuit Court of Appeals reversed the decision of the Board. (R. 42.)

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in holding that the most recently accumulated earnings or profits subject to tax as dividends in the hands of stockholders are limited to the net profits realized throughout the entire period intermediate February 28, 1913, and the date of dividend distribution.

2. The Circuit Court of Appeals erred in holding that corporate surplus existing as of March 1, 1913, must be considered as capital and if impaired may be replaced notwithstanding it has actually been risked and in part lost in the conduct of the business prior to the dividend distribution.

3. The Circuit Court of Appeals erred in failing to approve the method employed by the Commissioner of Internal Revenue whereby the taxable status of corporate distributions is fixed by first applying the profits realized in the period immediately preceding the dividend followed by those of

the prior years in inverse order to March 1, 1913, with allowance for dividends earlier paid, treating each year as a separate unit.

4. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

There is no constitutional objection to taxing dividends paid out of corporate earnings accumulated before March 1, 1913, and their exemption from tax is a matter of grace. The exemption must be limited to the express provisions of the statute, which are to be strictly construed. The losses sustained by the corporation in 1915 and 1916 necessarily reduced the surplus of March 1, 1913, since they could not diminish surplus not yet in existence. Distributions of earnings accumulated prior to March 1, 1913, do not constitute a return to the stockholder of part of his capital investment (*Lynch* v. *Hornby,* 247 U.S. 339) and Section 201 does not require that they be so treated. The section does no more than say that such earnings may be distributed free from tax upon the recipients. But if such earnings, instead of being distributed, are risked and lost in the business, later earnings may not be classified as surplus accumulated prior to March 1, 1913, and distributed free from tax.

The reasoning of the court below leads to conclusions so manifestly unreasonable and contrary to fact as to cast grave doubt on the court's interpretation of the Act.

II

The instant case is distinguishable from *Hadden* v. *Commissioner,* 49 F. (2d) 709, upon which the court below relied. In that case there was an operating deficit on March 1, 1913, which had to be made up out of future earnings before there could be an accumulated surplus. In the case at bar there was an earned surplus during all of the period in question. Only gains which create or increase an excess of assets over liabilities constitute "accumulated earnings." Here there were no "earnings or profits accumulated since February 28, 1913" until the year 1917, except for the small profit realized in 1914, which was wiped out by the losses sustained in the two succeeding years.

Section 201 creates a presumption that every corporate distribution is made from the earnings most recently accumulated. The method of computing the tax followed by the Commissioner in this case alone gives effect to the presumption.

III

The decision below is in conflict with established administrative practice which has received the implied approval of Congress through reenactment of the statute without substantial change.

ARGUMENT

I

THE EARNINGS OR PROFITS ACCUMULATED PRIOR TO MARCH 1, 1913, WERE REDUCED BY THE LOSSES SUSTAINED IN 1915 AND 1916, AND THERE IS NOTHING IN THE STATUTE WHICH PERMITS SUCH LOSSES TO BE OFFSET BY EARNINGS ACCUMULATED IN LATER YEARS FOR THE PURPOSE OF RESTORING THE SURPLUS HELD ON MARCH 1, 1913, TO ITS ORIGINAL FIGURE

Subdivisions (a) and (b) of Section 201 of the Revenue Act of 1921, *supra,* provide, on the one hand, that all distributions of corporate earnings or profits accumulated on or after March 1, 1913, are subject to tax upon receipt by stockholders, and, on the other hand, that all such earnings or profits accumulated prior to that time may be distributed free from tax. The problem in this case is to determine, under these provisions, what proportion of the $5,100,000 distribution made by the West Side Lumber Company on April 14, 1923, falls within one category and what proportion falls within the other.

The court below, in reversing the Board of Tax Appeals, held that the accumulated earnings from March 1, 1913, to April 14, 1923, can be ascertained only by deducting the losses of 1915 and 1916 from the total earnings of other years in that period, including the years subsequent to the loss years. It further held that the surplus existing on March 1, 1913, must, for the purposes of the Act, be considered capital, which, if impaired, may be re-

placed out of income before there can be any earnings accumulated subsequent to March 1, 1913.

In *Thorsen* v. *Commissioner,* 65 F. (2d) 234 (C.C.A. 9th),[2] which involves the tax of another stockholder of the West Side Lumber Company with respect to a part of the same distribution, the decision of the Board of Tax Appeals was sustained, and the position of the Commissioner was approved. In that case the court held that earnings accumulated before March 1, 1913, are not to be treated as capital for all income-tax purposes, and that the statute does not authorize restoration of surplus on that date after impairment thereof by losses. We believe that this is the correct view, and that the decision of the court below in the case at bar is unsound.

There is no constitutional objection to taxing dividends paid out of earned surplus accumulated before March 1, 1913. They were taxed under the Revenue Act of 1913, c. 16, Sec. II, A, B, 38 Stat. 114, 166, 167. *Lynch* v. *Hornby,* 247 U.S. 339. The Revenue Act of 1916 exempted such distributions,[3] but, as was said in the *Hornby* case, *supra,* p. 346, this was a grant of "a concession to the equity of stockholders * * * in view of constitutional questions that had been raised in this case, in the companion case of *Lynch* v. *Turrish,* and perhaps

[2] Pending on writ of certiorari, No. 212, October Term, 1933, to be argued with the case at bar.

[3] Sec. 2(a), c. 463, 39 Stat. 756, 757.

in other cases." The later Revenue Acts preserved the exemption,[4] even though constitutionally such dividends could be taxed. *Thorsen* v. *Commissioner,* 65 F.(2d) 234, *supra,* p. 235.

In respondent's brief in reply to the petition for certiorari it was argued that Section 201 is not an exempting clause, but rather defines the dividends which may be taxed, and that therefore the burden is upon the Commissioner to show that the distribution in question was from profits accumulated since February 28, 1913. While the section is, in form, definitive of a part of taxable income, we submit that in reality it is an exemption provision, manifestly designed to avoid the doubts raised in *Lynch* v. *Hornby, supra,* and similar cases. Under the decision in the *Hornby* case dividends constitute income to the recipient, whether distributed from earnings accumulated prior to March 1, 1913, or from earnings accumulated after that date, and the effect of Section 201 is to exempt from tax dividends which would otherwise be taxable.

The limits of the exemption must be found in express provisions of the statute. The words upon which respondent's claim to exemption must stand or fall are the following in Section 201 (b) (*infra,*

[4] See Section 1211 of the Revenue Act of 1917, c. 63, 40 Stat. 300, 336–338; Section 201 of the Revenue Acts of 1918, 1924, and 1926, c. 18, 40 Stat. 1057, 1059, c. 234, 43 Stat. 253, 254, and c. 27, 44 Stat. 9, 10, respectively; Section 115 of the Revenue Acts of 1928 and 1932, c. 852, 45 Stat. 791, 822, and c. 209, 47 Stat. 169, 203, respectively.

p. 21): "any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax." It is not so much a question whether the taxpayer's income falls within other language of the statute as it is a question whether it falls within this language. Unless it can be said that the income of the company during 1917, 1918, 1919, and part of 1920[5] was "earnings or profits accumulated * * * prior to March 1, 1913," it would seem that the decision of the court below must of necessity be reversed. An exemption from taxation is to be strictly construed against the taxpayer, and nothing is to be taken by inference or presumption. A well-founded doubt is fatal to a claim for exemption. *Bank* v. *Tennessee,* 104 U.S. 493, 495; *Bank of Commerce* v. *Tennessee,* 161 U.S. 134, 146; *Morris Canal Co.* v. *Baird,* 239 U.S. 126, 133; *Cornell* v. *Coyne,* 192 U.S. 418, 431; *Yazoo Railroad Co.* v. *Thomas,* 132 U.S. 174.

The court below held, in effect, that there were available for distribution in 1923 all of the earnings accumulated prior to March 1, 1913, in spite of the fact that losses had been sustained in 1915 and 1916. It is submitted that this conclusion is contrary to the facts and involves an erroneous interpretation of the statute. The losses sustained in 1915 and 1916 could serve only to reduce the sur-

[5] The income required to restore earned surplus to the amount held March 1, 1913.

plus existing at that time. Whether or not they were actually charged against prior earnings, their effect must necessarily have been to reduce the excess of assets over liabilities, and, therefore, to diminish the surplus held on March 1, 1913. The gains of later years were yet to come, and a loss suffered before their time could only diminish what the company already had. Cf. *Merriman* v. *Commissioner,* 55 F. (2d) 879, 880 (C.C.A. 1st). By way of illustration, had the company declared a dividend of $50,000 at the close of 1914, there would have been available for distribution, first, the profits realized in that year, and, second, the earnings accumulated prior to March 1, 1913. If after payment of the 1914 dividend the company had decided at the end of 1916 to declare a second dividend, there would have been available for distribution only the balance of the March 1, 1913 surplus remaining after the first dividend had been paid, less the losses sustained in 1915 and 1916. In other words, the assets actually available for distribution at the end of 1916 were less, by reason of the losses, than they would otherwise have been.

There remains the question whether, assuming that the 1915–1916 losses did reduce the March 1, 1913 surplus, there is anything in the statute which permits the replacement of the impaired surplus from earnings subsequently accruing. The court below held that the March 1, 1913 surplus must be regarded as capital, which may be restored before

dividends are paid out of later earnings. We submit that there is nothing in the Act which supports such conclusion. While earnings accumulated prior to March 1, 1913, may be deemed to have become capital in the hands of the corporation so that their receipt by the corporation prior to March 1, 1913, cannot be taxed (*Old Colony Railroad Co.* v. *Commissioner,* 284 U.S. 552), distribution of them to stockholders after that date does not constitute a return of the stockholders' capital investment. *Lynch* v. *Hornby,* 247 U.S. 339, *supra.* Nor, we submit, does the fact that Congress has in the Revenue Act of 1916 and subsequent Acts seen fit to refrain from taxing such distributions show that it intended to characterize as a return of capital something which, as this Court said in the *Hornby* case, would normally be regarded as income. The *Hornby* case shows clearly that we are not concerned here with the status of the earnings in the hands of the corporation, but with their status when received by the stockholder. The decisions of this Court which were cited and relied on by the court below (R. 42)[6] dealt with the status in the hands of a taxpayer of sums received by or accrued to the taxpayer itself prior to March 1, 1913. The statements in those decisions as to the capital nature of such assets would, therefore, seem to have no bearing on the present problem.

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[6] *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330; *Lucas* v. *Alexander*, 279 U.S. 573; and *Old Colony Railroad Co.* v. *Commissioner*, 284 U.S. 552.

The privilege conferred by Section 201 is one which enures to the benefit of the stockholder. The interest of the corporation is, at best, remote and, so far as taxation is concerned, the corporation has no interest. The tax does not fall, either directly or indirectly, upon it. Consequently, the rule for which we contend in no sense deprives the corporation of any right it might have to restore impaired capital. If the corporation chooses to hazard its accumulated earnings in the business, instead of distributing them, there would seem to be no grounds upon which the stockholders could complain. If earnings so hazarded are lost, that concerns the corporation alone, and it is difficult to see whereby the stockholders may insist, contrary to fact, that later gains be designated "earnings or profits accumulated * * * prior to March 1, 1913" and distributed free from tax in place of those lost. Congress has not expressly granted such a right of replacement, and we can conceive of no reason, constitutional or otherwise, for construing the statute as bestowing such right by implication.

The situation is clearly distinguishable from that involved in *Hadden* v. *Commissioner,* 49 F. (2d) 709 (C.C.A. 2d). There the corporation had an operating deficit which had to be made up before there could be any accumulated earnings available for distribution. In so far as the dividend there was not covered by earnings in excess of those re-

quired to restore the deficit, it was regarded as a return to the stockholder of part of his capital investment rather than income. Here the dividends were indubitably income to the stockholder, regardless of the extent to which they were taxable income.

The reasoning of the court below leads to conclusions so manifestly unreasonable as to cast grave doubt on the correctness of that court's interpretation of the statute. Thus, on February 29, 1916, the corporation had an earned surplus of $3,932,432, and on February 28, 1919, its earned surplus amounted to $4,259,566. The rule laid down by the Circuit Court of Appeals would require that the surplus as of February 28, 1919, although in excess of the surplus as of February 29, 1916, be regarded as having been accumulated in its entirety prior to March 1, 1913. Similarly, it follows from the court's reasoning that while the profits of the company realized during the year 1914 were earnings accumulated after February 28, 1913, its income during the period from 1917 to some time in 1920 constituted earnings or profits accumulated on or before that date. It is difficult to see how a construction of the revenue laws which leads to such unrealistic results can be sound.

II

ON THE FACTS OF THIS CASE THE EARNINGS OR PROFITS ACCUMULATED AFTER FEBRUARY 28, 1913, WITHIN THE MEANING OF THE STATUTE, CONSISTED OF THE AMOUNTS EARNED IN THE YEAR 1917 AND SUBSEQUENT YEARS

The issue, as shown above, is whether the West Side Lumber Company's income during the period from the beginning of 1917 to some time in 1920 constituted earnings or profits accumulated prior to March 1, 1913. Whether the income was accumulated on or after that date is relevant only as showing that it did not constitute earnings accumulated before that date. The conclusion of the court below rests mainly upon a statement in the case of *Hadden* v. *Commissioner,* 49 F. (2d) 709 (C.C.A. 2d), *supra,* that accumulated profits since March 1, 1913, must mean the net excess of all profits between that date and the date of distribution over losses sustained between those dates (R. 41).

The lower court, we believe, misconceived the meaning of the statute as to when earnings of a corporation constitute "accumulated" earnings and when they do not. It is important, we submit, in determining how much of earnings or profits a company has accumulated after February 28, 1913, within the meaning of Section 201, whether the company had an earned surplus on that date. Thus, while the procedure approved by the court below—merely ascertaining the net excess of profits over losses during the entire period between March 1, 1913, and the date of the distribution—may be

proper enough in calculating the earnings accumulated since February 28, 1913, where the company had an operating deficit on that date, as in the *Hadden* case, this method does not comply with the requirements of the statute in a situation like that in the case at bar, where the company at all times had a large earned surplus.

The phrase "accumulated earnings or profits" has the same meaning in Section 201 whether directed to the years before or the years after March 1, 1913, and there is nothing to indicate that it was intended to have any other than its usual significance. It means the amount by which a company's assets, by reason of earnings, exceed its liabilities, including capital stock. *Edwards* v. *Douglas,* 269 U.S. 204, 214–216; *Willcuts* v. *Milton Dairy Co.,* 275 U.S. 215, 218, 219; *Hadden* v. *Commissioner, supra,* p. 711. In the absence of such a surplus there are not accumulated earnings or profits, and income which merely decreases an operating deficit and restores impaired capital does not fall within the statutory language. As said in the *Hadden* case, *supra* (p. 711):

> Congress did not intend that a corporation should be held to accumulate profits for one tax purpose only and not for another. No earned surplus can be accumulated until the deficit or impairment of paid-in capital had been made good. Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus even though there are earnings of the tax-

> able year sufficient to pay the dividend in whole or in part. * * *

See also *Willcuts* v. *Milton Dairy Co., supra,* pp. 218, 219. Hence, only gains which create or increase an excess of assets over liabilities become accumulated earnings; and they become such, of necessity, only in the year in which they are made, for it is not until then that they come into existence.

In the *Hadden* case, accordingly, only income remaining after the deficit was wiped out became accumulated earnings, for it alone created or increased distributable earned surplus. In that case, as distinguished from this, early losses of the corporation were from paid-in capital, not from prior earned surplus. That case is manifestly not in point, and the statement therein which was relied upon by the court below should be read in the light of the facts to which it was directed. *Bramwell* v. *U.S. Fidelity Co.,* 269 U.S. 483, 489; *The San Simeon,* 63 F. (2d) 798, 802 (C.C.A. 2d).

In the present case, the company at all times material here had an earned surplus. At no time after February 28, 1913, was income needed or used for any purpose other than to increase surplus already held. True, the losses sustained in 1915 and 1916 diminished surplus, but, as has already been explained, that diminution was, except for the small gain in 1914, of earnings accumulated before March 1, 1913. The 1914 profit was wiped out by the subsequent losses, and no further earnings were accumulated until 1917. At the beginning of the

year 1917 the company possessed a distributable surplus of $3,932,432. Subsequent gains increasing that amount became accumulated earnings—those made in 1917 no less than the ones made in 1922. They all became earnings accumulated after February 28, 1913, and they are all in the category of earnings made taxable upon distribution.

Moreover, subdivision (b) of Section 201 (*infra*, p. 21) creates a presumption that every corporate distribution is made "from the most recently accumulated earnings or profits" to the extent that they were accumulated after February 28, 1913. See *McCaughn* v. *McCahan*, 39 F. (2d) 3, 5 (C.C.A. 3d); *Leland* v. *Commissioner*, 50 F. (2d) 523, 525 (C.C.A. 1st), certiorari denied, 284 U.S. 656; *Christopher* v. *Burnet*, 55 F. (2d) 527, 529 (App. D.C.). The plain import of this language is that in determining what proportion of a corporate distribution is taxable, accumulated earnings must be taken into the reckoning in the inverse order of their accumulation, as the Commissioner and the Board did in this case. This is the only method that satisfies the express provision of the statute. Since the company's gains herein dispute increased accumulated earnings in the years of their production, the Commissioner was required, under this provision, to include them in his computation of earnings accumulated since February 28, 1913.

Petitioner's contention is supported by *Blair* v. *United States*, 63 C.Cls. 193, certiorari denied, 275 U.S. 546. There a corporation at the end of 1918

distributed a dividend of $80,000, and the question was whether it was exempt from tax under Section 201 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1059. The court held it was not exempt, and in so doing necessarily applied the rule for which petitioner contends. The facts in that case parallel those in the instant case. The corporation during 1913, 1914, and 1915 had losses amounting to $157,848.19. During the next three years it had gains of $136,653.79. Thus, after February 28, 1913, losses exceeded gains by $21,194.40. Under the ruling of the court below, the dividend would not have been taxable, and this view would have been proper had there been a deficit on March 1, 1913. But there was on that date a surplus of $106,460.51 (p. 195). The losses in 1913, 1914, and 1915 wiped out the surplus of March 1, 1913, and left the corporation with a deficit on December 31, 1915, of $51,387.58, but the earnings of the next three years after making good this deficit provided a surplus of accumulated earnings sufficient to pay the dividend. The case is directly in point. See also *Edwards* v. *Douglas*, 269 U.S. 204.

III

THE DECISION OF THE COURT BELOW OVERTURNS SETTLED ADMINISTRATIVE PRACTICE WHICH HAS RECEIVED IMPLIED LEGISLATIVE APPROVAL

The procedure followed by petitioner in this case conforms with the established practice of the Bureau of Internal Revenue over a period of many years. A.R.M. 82, 3 Cumulative Bulletin 36 (1920);

G.C.M. 3532, VII-1 Cumulative Bulletin 190, 191–193 (1928). During this time Congress has repeatedly reenacted the substance of the provision involved.[7] The departmental interpretation must, therefore, be deemed to have had the approval of Congress. *National Lead Co.* v. *United States,* 252 U.S. 140; *Brewster* v. *Gage,* 280 U.S. 327, 337; *Universal Battery Co.* v. *United States,* 281 U.S. 580; *Fawcus Machine Co.* v. *United States,* 282 U.S. 375, 378; *McCaughn* v. *Hershey Chocolate Co.,* 283 U.S. 488; *United States* v. *Kirby Lumber Co.,* 284 U.S. 1; *Murphy Oil Co.* v. *Burnet,* 287 U.S. 299. If the administrative practice had been contrary to the intention of Congress, it undoubtedly would have been corrected in later Acts. *Heiner* v. *Colonial Trust Co.,* 275 U.S. 232, 235; *Massachusetts Mutual Life Ins. Co.* v. *United States,* 288 U.S. 269, 273.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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NOVEMBER 1933.

[7] See note 4, *supra*, p. 9.

APPENDIX

Section 201 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 228, provides in part:

> SEC. 201. (a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913, except a distribution made by a personal service corporation out of earnings or profits accumulated since December 31, 1917, and prior to January 1, 1922.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. If any such tax-free distribution has been made the distributee shall not be allowed as a deduction from gross income any loss sustained from the sale or other disposition of his stock or shares unless, and then only to the extent that, the basis provided in section 202 exceeds the sum of

(1) the amount realized from the sale or other disposition of such stock or shares, and (2) the aggregate amount of such distributions received by him thereon.

* * * * *

Treasury Regulations 62 (1922 ed.), promulgated under the Revenue Act of 1921, provide in part:

ART. 1542. *Source of distribution.*—(*a*) For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913;

* * * * *

ART. 1543. *Distribution out of earnings or profits accumulated prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, * * * is not a dividend within the meaning of the Act. * * * A corporation cannot distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. In determining whether a dividend is out of earnings or profits accumulated prior or subsequent to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 158

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES J. CANFIELD

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

The problem in this case is to determine what part of a dividend declared and paid in 1923 was derived from earnings accumulated by the corporation prior to March 1, 1913, and was therefore exempt from tax, and what part was from earnings accumulated after that date and was therefore taxable. The respondent approaches the question by endeavoring to ascertain the amount subject to tax. The Commissioner, on the other hand, taking the

[1] The arguments herein advanced apply equally to the companion case of *Thorsen* v. *Commissioner*, No. 212. To avoid repetition we are filing no separate reply or supplemental brief in that case.

view that dividends generally are income to the recipients (see *Lynch* v. *Hornby,* 247 U.S. 339) and that Section 213 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 238, taxes "income derived from any source whatever" unless such income is specifically declared deductible or exempt, seeks to determine what portion of the dividend is exempt from tax.

The Commissioner's approach to the question seems justified, not only by the history of Section 201 of the Act, which is discussed on pages 8 and 9 of our original brief, but by the express provisions of subsection (b), which reads in part:

> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; * * *

It is argued on behalf of the taxpayer that this provision was inserted in the 1917 Act with reference to the taxation of corporate distributions at the rate prevailing in the year of their accumulation, and was continued in the 1918 Act and later revenue statutes only for purposes having to do with personal service corporations. The language of the subsection is, however, much broader than this, and although it undoubtedly had reference to these matters, we submit that it is also of general application. In the 1918 Act this provision appeared in the following form:

> (b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. *Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913,* or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; * * * (Italics ours.)

The passage in italics clearly had no application to personal service corporations, since special provision was made for them. Subsection (b) created two presumptions: first, that a distribution was from earnings or profits, rather than from capital; and second, that it was from earnings or profits accumulated since February 28, 1913, as distinguished from those accumulated prior to that time. The effect of those presumptions was, we submit, to place upon the taxpayer the burden of showing that a dividend received by him was not taxable, either because it was a return of capital or because it was derived from sums earned before March 1, 1913. There seems to be no justification for construing the analogous provision of the 1921 Act, which is framed in the broadest terms, as discarding the two presumptions mentioned and retaining only the third, relative to personal service corporations. It seems reasonably evident that Congress, realizing that all three presumptions could

be included in a single provision, reframed the section accordingly.

But whether the burden be upon the Commissioner or upon the taxpayer, we contend that subsections (a) and (b) are essential parts of the same general provision, and that neither one can be correctly understood without taking the other into consideration. The respondent appears to look upon subsection (a) alone as determinative of the issues raised, and argues that (b) performs only certain subordinate functions. We take the position that doubts arising as to the proper construction of (a) can be resolved only by referring to (b), and that the emphasis in Section 201, when that section is read as a whole, is laid upon the exemption of earnings accumulated prior to March 1, 1913, rather than upon the taxation of earnings subsequently accumulated.

In the last analysis, the respondent's position is wholly dependent upon the proposition that the statute contemplates two "wholly independent" periods, the first embracing all time prior to March 1, 1913, and the second all time between that date and the date of the dividend payment. If this proposition is unsound, it seems that the respondent's entire argument must fall.

The respondent asserts that the intention of Congress to create two wholly independent periods

is self-evident [2], but we find nothing in the brief to support this interpretation of the Act. That Congress regarded March 1, 1913, as marking a point of division for certain purposes is, of course, beyond dispute; but whether it contemplated that the periods before and after that date should be independent of each other, in the sense that nothing occurring in the later period could possibly reduce the mass of earnings in existence at the close of the earlier, is a wholy different question. The respondent's argument seems to go too far, for he says (Br., p. 12) that "If there were a deficit in 1913, instead of a surplus, that of course, would have to be made up, but the method of determining the accumulation would, in fact, remain the same under all factual situations * * *." Yet it would manifestly be impossible to restore a 1913 deficit out of later earnings if, as the respondent insists, the two periods must be kept entirely separate and independent of each other. Nor, if the deficit is to be restored, will earnings accumulated in the post-1913 period be the net of all operations during that period; they will plainly be the net of those operations *less* the amount of the pre-existing deficit.

In the brief for the petitioner in the *Thorsen* case, No. 212 (p. 28), reference is made to certain

[2] See respondent's brief, p. 7; brief for petitioner in the *Thorsen* case, p. 15.

committee reports relative to the 1924 Act, in which it was said that the theory upon which earnings accumulated before March 1, 1913, are allowed to be distributed free from tax is that the distribution constitutes a return of capital to the stockholder. We submit, however, that upon analysis this statement will be found to be of little value. Distribution of earnings accumulated prior to March 1, 1913, is, in fact, no more a return of capital than is a distribution of earnings accumulated after that date. See *Lynch* v. *Hornby,* 247 U.S. 339. It is apparent, therefore, that the statement of the committee can mean no more than that Congress believed itself bound to treat ante-1913 earnings as capital, and that having so treated them to the extent of permitting their distribution free from tax it did not intend that the taxpayer should reap the benefit of the exemption a second time when the stock was sold at a profit. Moreover, the same committee report from which the taxpayer quotes indicates that Congress has not treated these earnings as capital for all purposes. We refer to the following statement (H.Rep. No. 179, 68th Cong., 1st Sess., p. 11):

> Since distributions out of earnings and profits accumulated prior to March 1, 1913, and distributions out of capital are in some instances treated differently, it is material to know the source of a given distribution, even though all earnings and profits accumulated since March 1, 1913, have been dis-

> tributed. Consequently, in section 201 (b) of the bill the presumption that every distribution is out of earnings and profits applies to all earnings and profits, whether accumulated prior or subsequent to March 1, 1913, thus clarifying and making more certain the law.

It may be observed, also, that the 1921 Act did not treat these distributions as a return of capital for the purpose of computing gain upon the subsequent sale of the stock, but only for the purpose of determining the amount of a loss. See *Newman* v. *Commissioner,* 9 B.T.A. 158. Section 201 (b) of the 1924 Act changed the law in this respect.

In our original brief we sought to distinguish the case of *Hadden* v. *Commissioner,* 49 F. (2d) 709 (C.C.A. 2d), on the ground that the corporation there had a deficit on March 1, 1913, which had to be made up before there could be earnings available for distribution. The respondent challenges this distinction, stating that the corporation had an earned surplus on March 1, 1913, and that the case is therefore directly in point. We have been unable to find anything in the decision as reported or in the related cases cited on page 13 of the respondent's brief justifying this statement. The taxpayer in the *Hadden* case took the position that no surplus existed, whereas the Commissioner insisted that the absence of a surplus had not been shown. The court apparently agreed with the taxpayer, for it said (p.

710) that the company "had no profits from its organization until March 1, 1913," and that "petitioner's contention is that there were no earnings or profits accumulated on March 1, 1913." Its opinion seems plainly to proceed on the assumption that the petitioner's contention was correct. If the court was mistaken as to the facts, nevertheless its decision must be read in the light of the facts as it saw them. If in fact there were earnings accumulated before March 1, 1913, we submit the decision was erroneous.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 158

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CHARLES J. CANFIELD.

REPLY BRIEF OF CHARLES J. CANFIELD TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

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OPINIONS BELOW.

The opinion of the Board of Tax Appeals is reported in 24 B. T. A. 480. The opinion of the Circuit Court of Appeals is reported in 62 Fed. (2d) 751 and is reprinted in the record at page 42.

THE FACTS.

The facts are summarily set forth at pages 3 and 4 of the petition for the writ. There is no incorrect statement therein of importance, but it adds something to a clear perception of the issue to set out the actual profits and losses for the period beginning March 1, 1913, and ending April 14, 1923. They were as follows:

Year Ending	Profits	Losses
February 28, 1914.....	$ 4,594.62	
February 28, 1915.....		$193,139.67
February 29, 1916.....		211,707.32
February 28, 1917.....	60,495.56	
February 28, 1918.....	57,901.55	
February 28, 1919.....	208,737.34	
February 29, 1920.....	543,490.33	
February 28, 1921.....	640,837.43	
February 28, 1922.....	182,954.63	
February 28, 1923.....	718,858.29	
March 1, 1923, to April 14, 1923 (44/366 of $311,209.54)	37,413.17	
Totals	$2,455,282.92	$404,846.99

The difference between such totals is $2,050,435.93. The undistributed net balance arising out of 1913-1923 operations was thus, as of April 14, 1923, $760,435.93, which is, of course, the exact amount of the excess in the surplus of that date over the surplus of March 1, 1913.

The issue is whether that addition to surplus constituted on April 14, 1923, the undistributed "earnings or profits accumulated since February 28, 1913,"

within the meaning of Section 201 (a) of the Revenue Act of 1921, or whether the total of the profits of the several years from *March 1, 1916,* to April 14, 1923, viz., $1,160,658.30 (without deduction of the losses of $193,139.67 and $211,707.32 incurred in the years ending February 28, 1915, and February 29, 1916) constituted on April 14, 1923, such undistributed earnings or profits "accumulated *since February 28, 1913.*"

Reasons for Granting the Writ.

The Commissioner has given two reasons for granting the writ of certiorari in this case.

A.

The first (p. 5) is that there is a conflict between the decision in this case and the decision in the case of *William R. Thorsen* v. *Commissioner,* decided May 19, 1933, in the Ninth Circuit. This is true.

The Commissioner says further that the decision herein below "is believed to be in conflict with that of the Court of Claims in *Blair* v. *United States,*" 63 Ct. of Claims 193. This is incorrect. In the Blair case there was no surplus on March 1, 1913, and therefore the case is not in point. The very brief opinion stated that the corporation therein involved had "a loss in excess of its gains *for the period of its corporate existence,* as well as for the period from March 1, 1918 (evidently a misprint for 1913, as it had a profit of $84,868.39 for the period March 1, 1918, to December 31, 1918; see Finding of Fact 10.) to December 31, 1918." Finding of Fact 10 made by the court shows a net loss from March 1, 1913, to December 31, 1918,

of $21,194.40. The Commissioner claimed a March 1, 1913, surplus of $106,460.51 (due to his treatment of an item of $546,460.51 of surrendered bonds and coupons). But for these bonds and coupons, there was a capital deficit on March 1, 1913, of $440,000. To satisfy the conditions, therefore, of the court's statement of a corporation with "a loss in excess of its gains for the period of its corporate existence" there could not have been a surplus up to March 1, 1913, of more than the $21,194.40 loss after that date—and that is not what the Commissioner claimed as a surplus.

It is therefore evident that the court treated the case as one with a capital deficit of $440,000 on March 1, 1913, a further (operating) deficit of $21,-194.40 for the period March 1, 1913, to December 1, 1918, and an operating profit in the calendar year 1918 of $84,868.39, from which the dividend of $80,-000 was paid in December, 1913. The court said: "It was a distribution of earnings and profits in 1918." In consequence, as there was no surplus whatever on March 1, 1913, but instead a large deficit, *Blair* v. *Commissioner* does not at all involve the principle in the case at bar, which concerns the proper treatment of a *surplus* existing on that date. Also the Blair case arose under the 1918 Act while this arises under the 1921 Act and the two Acts are radically different. There is no conflict between the decision in the Canfield case and the decision in the Blair case.

B.

The second reason for granting certiorari given by the Commissioner (p. 6) is that the decision of the court below herein is unsound. This point is not

valid. To the contrary, it is submitted that the decision below is indubitably right. It is the decision in the Thorsen case on which the Commissioner relies that is wrong.

1. The only authority anywhere in the 1921 Act to tax dividends in the hands of the recipient is found in Section 201 (a). That section taxes "any distribution made by a corporation to its shareholders or members * * * out of its earnings or profits *accumulated since February 28, 1913.*" No other dividends are taxable. The section involves no element of exemption of certain dividends from the tax imposed by any other provision of the act, as asserted by the Commissioner's brief, page 6. It merely specified what dividends *are* taxed. The burden, therefore rests on the Commissioner to show that the distribution in question was from such profits so accumulated. Otherwise they are non-taxable. The act creates two periods breaking on March 1, 1913. The accumulated earnings prior to that date are non-taxable and the earnings accumulated and distributed after that date are taxed.

2. The Commissioner claims that the earnings for the period of *March 1, 1916,* to April 14, 1923, are the accumulated earnings for the period of *March 1, 1913,* to April 14, 1923, which the statute has created. He wholly excludes from the reckoning the period of March 1, 1913, to March 1, 1916, without any statutory authority therefor, inasmuch as such last named period is included in and is a part of the larger period "since February 28, 1913," named by the act as the period the accumulations of which are taxed. In short, he has segregated a portion of the period and the earnings thereof as though thereby he were measuring the accumulations of the

entire period. As the tax is levied upon the profits accumulated in a specified period *as such,* the entire period and not the several years composing it or any fractional part of the period, is the unit of computation.

3. The only amount that the corporation can be said to have *"accumulated"* since February 28, 1913," is the net of its operations since that date. It cannot be said to have accumulated the totalled profits of certain years within that period without regard to loss years within it. It will have accumulated in a given year the net *of that year,* but for the *period* (covering over ten years) it accumulated not these several nets added together, but that total minus its losses in the loss years of the period. Otherwise, in effect, the words "profits accumulated since February 28, 1913," are stricken from the act. This computation gives the exact figure which the court below held to be correct. Thus the surplus of March, 1913, is left intact and is distributable tax-free.

4. The foregoing approach to the problem exactly co-ordinates with the result arrived at by considering the nature of the surplus of the first period.

5. This court has repeatedly* spoken of the surplus of March 1, 1913, as "capital for the purposes of the act." Capital is not taxable upon distribution. If it be temporarily impaired, it may always be replaced from subsequent earnings. Upon replacement, it is then distributable, as before, tax-

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**Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, 62 L. Ed. 1142, 38 S. Ct. 540; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, 63 L. Ed. 133, 39 S. Ct. 35; *Lucas* v. *Alexander*, 279 U. S. 573, 73 L. Ed. 851, 49 S. Ct. 426; *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, 76 L. Ed. 484, 52 S. Ct. 211.

free. This mode of approach arrives at the same result as that reached by interpreting the words "accumulated since February 28, 1913"—that the only taxable distribution is that of the net of the second period.

6. The Act of 1921 therefore taxed to the recipient Canfield only his share of the net of the period "since February 28, 1913," and left inviolate for distribution to him his share of the surplus of March 1, 1913—made "capital, not income, for the purposes of the act."

7. The Commissioner's brief, page 7, asserts that the decision below "ignores the accepted principles of accounting and and the actualities of the situation." This is not the fact. The statute by creating two separate periods, one tax-free and the other subject to tax, requires the setting up of two separate profit and loss accounts, whereas the Commissioner in violation of correct principles of accounting merges the two.

Nor does the position of the court ignore actualities. There is nothing in the record to show that West Side Lumber Company could in fact have distributed instanter, $4,332,684.78 of its total assets of $5,833,684.78. This would have required a 74 per cent liquid position—one scarcely to be anticipated for any corporation, and in particular not for a lumber company, with its capital necessarily largely invested in fixed assets. It would be an unreasonable interpretation to require instant liquidation in order to take advantage of the tax-free provision, for Congress did not anticipate the liquidation, but the continuance of corporate enterprises.

This is the more obvious from the fact that the act *in 1921* provided that the *March 1, 1913,* surplus

might then be distributed tax-free. Why should temporary fluctuations in position in 1915 and 1916 be deemed to have been important, when Congress in 1921 recognized the whole March 1, 1913, surplus, after the lapse of eight years, to be *then* distributable without tax? The opinion of the lower court therefore accords with actuality. The Commissioner ignores it.

8. The Commissioner asserts that the decision runs counter to his "settled and consistent administrative interpretation of the statute." If this be true (a matter we do not concede), still it is not the rule that an administrative official can by misinterpreting a statute bind the courts to his erroneous view. (*Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1; 76 L. Ed. 359; 52 S. Ct. 275.) There is nothing to indicate that Congress was informed of his misinterpretation or ever considered the artificial issue which he has raised, apparently in the teeth of the simple, practical and evident meaning of the act. The cases have only reached the courts, so that until now there has been no reason why Congress should have considered the question at all. It plainly enough indicated its purpose and intent in the language it originally employed. The Commissioner has invented the issue in his favor from his views of bookkeeping instead of seeking to ascertain the intent of Congress from the act.

Respectfully submitted,

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BARRY GILBERT,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1933.

No. 158

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CHARLES J. CANFIELD,

Respondent.

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF IN BEHALF OF RESPONDENT, CHARLES J. CANFIELD.

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CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF IN BEHALF OF RESPONDENT, CHARLES J. CANFIELD.

I.

Official Reports of the Opinions Delivered Below.

The opinion of the Circuit Court of Appeals for the Seventh Circuit in this case is found in 62 Fed. (2d) 751. The Findings of Fact, Opinion and Decision of the Board of Tax Appeals are reported in 24 B. T. A. 480 (Trans., 22).

II.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered January 13, 1933 (Trans., 46). The petition for a writ of certiorari was filed on June 10, 1933, and was granted on October 9, 1933. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

II.

Statement.

This case is a companion case to *William R. Thorsen, Petitioner,* v. *Guy T. Helvering, Commissioner of Internal Revenue, Respondent,* No. 212, October Term, 1933, 65 Fed. (2d) 234.

The facts are identical save only that Canfield, the Petitioner in this case, did not have as many shares of West Side Lumber Company stock as did Thorsen and hence did not receive so large a dividend payment.* The point of law to be decided is the same in

* Canfield originally returned 16.35 per cent of the dividend received by him, or $33,360, as taxable. If his contentions herein be upheld the taxable per cent of the dividend will be 14.91 per cent. The difference between these two figures is due to certain errors in the original income tax return of West Side Lumber Company, which were later corrected by the Commissioner. Canfield in making his return followed the figures in the Company return. Therefore, if the percentage of 14.91 be correct, he is entitled herein to a refund, as he should have reported $30,414, instead of $33,360, as taxable. (He also reported a dividend of $6,000 received by him on February 12, 1923, about which no question is raised.) Because the recomputations by the Commissioner in his review of the return of West Side Lumber Company lowered its net income, $6,879.29 of the dividend of April 14, 1923, paid before that review, was in fact paid out of paid-in capital.

both cases. The Circuit Court of Appeals of the Seventh Circuit in this case reversed the decision of the majority (eight members) of the Board of Tax Appeals and accepted the view of the dissenting minority of seven members. The Circuit Court of Appeals for the Ninth Circuit affirmed the decision of the majority.

The Petitioner Thorsen in case No. 212 is represented by counsel who represent the Respondent Canfield in this case. A brief has been filed for the Petitioner in the Thorsen case. In the interest of brevity, the Respondent here adopts and incorporates herein by reference the brief for Petitioner in the Thorsen case.

Thus, this brief is not designed as a complete argument. It is designed only to deal with such parts of Petitioner's argument as were not adequately treated in the other brief.

IV.

Summary of Argument.

I.

The statute fixes two periods with respect to the taxation of dividends—one beginning March 1, 1913, and the other ending on February 28, 1913. Dividends paid from earnings and profits accumulated after March 1, 1913, are taxed; all other dividends are tax-free. The amount accumulated during the taxable period is the excess of profits over losses for the entire period.

II.

The Petitioner has improperly construed Section 201 of the Revenue Act of 1921. He has given a wrong meaning to the word "accumulated" and has improperly determined the amount of Respondent's dividend subject to tax.

III.

There is nothing to show that the administrative practice of the Bureau of Internal Revenue received the implied approval of Congress. The Bureau by misinterpreting a statute cannot bind the courts to an erroneous conclusion nor can it require Congress to pass legislation to correct its errors.

V.

ARGUMENT.

I.

The Construction of the Statute and Its Application to the Facts of This Case.

This controversy grows out of the assertion by Petitioner (the Commissioner of Internal Revenue), of the right to assess and collect an additional income tax because of the receipt by Respondent (the taxpayer) of a dividend from West Side Lumber Company. Both the Commissioner and the taxpayer agree that part of this dividend should be taxed and that the balance should be tax-free. Both agree that the part subject to tax is that part paid out of the earnings or profits of the corporation "accumulated since February 28, 1913". The taxpayer, in computing and paying his tax, determined the amount so accumulated by taking the difference between the profits and the losses—the income and the outgo—from February 28, 1913, to the date of the declaration of the dividend. He reported and paid his tax on that basis.

The Commissioner, on the other hand, approached the computation of the taxable portion of the dividend in a quite different way. Agreeing with the taxpayer as to the amount of the accumulations prior to March 1, 1913, but finding that the net operations for the next three years resulted in a large loss, he *excluded* this loss from his computation of the accumulations since February 28, 1913.

At the very threshold of the argument of the Commissioner we note the difference in his manner of approaching the problem. He is right in saying that the dividends paid out of accumulations before March 1, 1913, *might* have been taxed; and the taxpayer is right when he answers by saying that they are *not* taxed. It is all a matter to be determined by Congress; and Congress has said that only dividends paid out of accumulations after February 28, 1913, are to be taxed. The taxpayer approached the problem by endeavoring first to find out what *is* taxed. The Commissioner approaches the problem by endeavoring to find out what is *not* taxed. Therein, we submit, is the fundamental error of the Commissioner in this case.

This leads the Commissioner to say (Brief, p. 9) that the taxpayer must bring himself within an exemption. He stresses this point. It seems entirely clear that when the Commissioner asserts the right to collect a tax, it is for him to point out his authority to do so. But his argument seems to be that because Congress might have levied a tax on all dividends, he is relieved from that duty, and that for some reason there passes to the taxpayer the burden of showing that he is not subject to the tax.

Section 201 (a) determines what dividends only are taxed—those paid "out of earnings and profits accumulated since February 28, 1913". Section 201 (b) does not define the subject of taxation; it is purely supplementary to paragraph (a) and (so far as we are concerned here) merely provides that the taxable accumulations since February 28, 1913, must be distributed before the tax-free accumulations prior to March 1, 1913, may be distributed. This

provides nothing more than a sequence of distribution.

Section 213 of the Revenue Act provides that dividends are taxed, but 201 (a) defines the term "dividend" as used in Section 213. The question, therefore, is: what part of the dividend in this case was paid out of accumulations made subsequent to March 1, 1913? No more than that part may be taxed. Thus there can be no question of exemption. This case, therefore, is not a case for the application of the rule that an exemption is to be strictly construed against the taxpayer. Clearly it is simply a case of the construction of a taxing statute, which is to be construed against the Government and in favor of the citizen.

The Commissioner speaks (Brief, p. 13) of the "privilege" conferred by Section 201 inuring to the recipient of a dividend. We submit that there is nothing in this section which savors of conferring a privilege. Congress has the right to say what dividends shall be taxed and when it has said that certain dividends shall be taxed, it can only mean that others are not taxed; and the Commissioner does not go so far as to say that the receipt of tax-free income is a privilege.

The Commissioner, it would seem, has overlooked another very important point of Section 201, namely, that it creates two distinct and separate periods for tax purposes. Accumulations for the period after March 1, 1913, are taxed; all others are tax-free. It thus follows that the accumulations for each period are a fixed and static amount, not to be changed by happenings after the end of the period. The accumulations for the *period* after February 28, 1913,

must be the difference between the income and the outgo for the *period*. Thus, the taxpayer computed and paid his tax. Likewise it must be that the accumulations before March 1, 1913, were a fixed and definite amount determined *as of that date* and not subject to change by happenings after that date.

We submit that it is because of failure to recognize the two definite and distinct periods fixed by the law, that the Commissioner falls into the error in computing the amount of the tax in this case, of actually using three, and not two, periods. Beginning with March 1, 1913, there were three years where the aggregate losses were greater than the profits. During the following years up to the date of the declaration of the dividend, there were only profits. What the Commissioner has done (Trans., 13-14), in fact, is to take the aggregate of profits only of the period from March 1, 1916, to the date of the declaration of the dividend and then to assert that this aggregate is the profits "accumulated since February 28, 1913". He then takes the net loss for the intervening years 1914, 1915 and 1916 and says that it must be carried back and considered as a diminution of the March 1, 1913, surplus. If profits had preceded losses after March 1, 1913, the Commissioner would have computed the accumulations for the taxable period in precisely the same way as Respondent does; but because the losses came first he segregates three years from the taxable period created by the statute, and asserts his right to tax the accumulations from March 1, 1916, to the date of the dividend, wholly ignoring the declaration of Congress that the taxable period begins on March 1, 1913. Thus the Commissioner's construction of the statute apparently depends, not upon what it so

clearly says, but on the mere accident of the sequence of profits and losses.

The Commissioner says that it follows from the reasoning of the court below, that profits from 1917 to 1920 are considered as being earnings or profits accumulated prior to March 1, 1913. (Brief, p. 14.) He speaks of this as "unrealistic." It is apparent that the court below did not so consider any part of the profits earned after 1917. What the court below did was to interpret first that part of the law which defined what was to be taxed as having been accumulated during the taxable period beginning on March 1, 1913 and ending on the day of the declaration of the dividend. It determined that in order to find the accumulations during the taxable period after February 28, 1913, it must consider the period fixed by Section 201 (a) *in its entirety,* (and not certain years or separate years) and find the difference between the profits and the losses for all the years of the period. Thus it determined rightly, we submit, the amount subject to tax. It left the accumulations of the first period precisely as they were on the first day of March, 1913, a fixed and static amount. It dealt with the first three years' losses as if they were held in suspense and wiped out by the later profits, leaving a net profit or net accumulation for the period.

It would seem that throughout his whole argument the Commissioner has ignored the indisputable fact that Section 201 creates two distinct periods. This leads him at one point erroneously to state the issue (Brief, p. 15), and at another point to speak of the surplus of February 28, 1919 (Brief, p. 14).

What the surplus was at any time during the taxable period must be wholly immaterial in determining the surplus accumulated for the whole period. How to determine the accumulations during the taxable period after February 28, 1913, is the issue in this case.

After having properly construed the Act and defined the word "accumulated", the court below then said that the surplus as it existed on the first day of March, 1913, must be dealt with as if it were capital for the purposes of the act. We submit that the court below, in so construing the statute and computing the amount subject to tax, approached the problem properly and arrived at a sound conclusion. That surplus may be considered and dealt with under a tax law as if it were capital is well settled.* As was said in the dissenting opinion before the Board of Tax Appeals:

> "It seems to me too clear for controversy that any surplus existing on February 28, 1913, has no connection whatever with what the accumulated surplus since that date is." (Trans., 63.)**

Here, we submit, is the gist of the whole question. When Congress said, in effect, (in taxing only divi-

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* *Southern Pacific Company* v. *Lowe*, 247 U. S. 330. *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71. *Eisner* v. *Macomber*, 252 U. S. 189. *Lucas* v. *Alexander*, 279 U. S. 573. *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552.

**The Board of Tax Appeals, in *Walker* v. *Commissioner*, 27 B. T. A. 829, in an opinion therein stated to have been prepared before (but which was announced after) the decision in this case in the Circuit Court of Appeals for the Seventh Circuit, squarely reversed its previous position and adopted the views asserted by Canfield, the respondent here, and Thorsen, the petitioner in the companion case. After the decision of the Circuit Court of Appeals of the Ninth Circuit in the Thorsen case, the Board refused to reconsider the Walker case, although Walker is a resident of the Ninth Circuit. It adhered to its decision in the Walker case in *Bouton: Garrett et al.* v. *Commissioner*, Mem. Op. March 10, 1933. Thus, the Board of Tax Appeals, the Circuit Court of Appeals for the Second Circuit in *Hadden* v. *Commissioner*, 49 Fed. (2d) 709, and the Circuit Court of Appeals for the Seventh Circuit, all accept the theory of the petitioner here. The only opposing decision is the one of the Circuit Court of Appeals for the Ninth Circuit in the Thorsen case.

dends from accumulations after March 1, 1913) that dividends paid out of surplus accumulated prior to March 1, 1913, were not to be taxed, it meant the surplus as it existed on that day—an amount which could neither be increased (this the Commissioner will concede) nor diminished by any subsequent occurrence, and if that is so, the Commissioner's argument fails.

The Commissioner says (Brief, p. 9) that the words upon which the taxpayer must stand or fall are certain words, which he quotes, in paragraph (b).

> "any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax."

This, we submit, is quite incorrect. These words are not the source of the Commissioner's authority to tax. And it is not the source of the taxpayer's right to receive a part of the dividend tax-free. The right of the taxpayer to receive a part of the dividend tax-free arises, instead, out of Section 201 (a). If paragraph (b) were struck from the act, the taxpayer's right clearly would remain. There was no paragraph (b) in the Act of 1916, but by Section 2 (a) of that act, the surplus of March 1, 1913, was distributable tax-free. Paragraph (b) performs only certain subordinate functions. It creates no primary rights whatever.

The Commissioner says (Brief, pp. 11-13) that the March 1, 1913, surplus is "hazarded" in the business, and that if losses occur, inasmuch as there is no express provision in the act for its replacement, it must be deemed "lost". This is but a bookkeeping conception. Congress has taxed only the earnings "accumulated since February 28, 1913." Hence,

there is nothing to tax until that period had shown an excess of earnings over losses. The tax is on such excess. By then the surplus of March 1, 1913, has of necessity been "restored". No express provision is necessary. The result follows of necessity from the language of paragraph (a) and is automatic.

II.

The Real Issue in This Case Is How to Compute the Taxable Portion of the Taxpayer's Dividend.

The Commissioner argues (Brief, p. 15) that it is important in computing how much of the earnings and profits a corporation has accumulated after February 28, 1913, within the meaning of Section 201, to determine whether the corporation had an earned surplus on that date. As a result, in construing the word "accumulated" the Commissioner would have it mean one thing if there was an earned surplus on March 1, 1913, and quite another thing if there was no such surplus. This, we submit, illustrates clearly a mistaken bookkeeping concept on the part of the Commissioner. If Congress has fixed two distinct and separate periods ending and beginning on March 1, 1913, and has declared that only the accumulations after that date are taxed, it means that the computation must begin on that date and end on the day of the date of the declaration of the dividend. If there were a deficit in 1913, instead of a surplus, that of course, would have to be made up, but the method of determining the accumulation would, in fact, remain the same under all factual situations, so that the court below was correct in accepting the rule laid down in *Hadden* v. *Commissioner,* 49 Fed. (2d) 709:

"and the accumulated profits since March 1,

> 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *"

As a matter of fact, it appeared in several cases* involving the same corporation whose dividends were under consideration in the *Hadden* case, that in reality there was a surplus on March 1, 1913,—growing out of the fact that the increase in the value of the company's assets was more than sufficient to offset the operating deficit. But irrespective of that fact, the rule laid down in that case is indubitably the correct rule for determining what are the earnings and profits of a corporation accumulated after February 28, 1913. This was the rule followed by the court below in this case.

The Commissioner asserts (Brief, p. 18) that the words "most recently accumulated earnings or profits" to the extent that they were accumulated since February 28, 1913, in paragraph (b) of Section 201 require earnings to be taken into the reckoning in the inverse order of their accumulation,—that is, the profits of 1923, then those of 1922, and so on, until the loss year of 1916 is reached. These words have no such effect. They were inserted in the 1917 Act to compel the distribution of 1917 earnings, bearing the war rates, ahead of 1916 earnings, bearing the pre-war rates. They were continued in the 1918 Act only as to "personal service corporations", and have been put in later acts solely because of the different tax treatment for a time (1918-1922) accorded to such corporations. They have reference only to differences as between the several years of the pe-

**Trustees* v. *Commissioner*, 15 B. T. A. 273; *Kountze* v. *Commissioner*, 17 B. T. A. 928; *Hadden* v. *Commissioner*, 17 B. T. A. 956.

riod *after* February 28, 1913, and have nothing to do with the mode of arriving at the taxable and non-taxable portions of a dividend as between the two periods before and after March 1, 1913.

That the Commissioner has misconstrued paragraph (b) is obvious from a mere reading of the 1916 and subsequent acts in the light of the situations they were designed to meet and what clearly they were intended to accomplish. The Commissioner says (Brief, p. 18) that the "plain import" of the language of paragraph (b) requires the reckoning to be made in the inverse order of the years, obviously overlooking the significant words *"to the extent that they were accumulated since February 28, 1913."* This is the whole story. We need not go beyond the words of the 1921 act. These words recognize the taxable *period* which the Commissioner ignores. In connection with the later words in the paragraph, they mean only (so far as they have application here) that a corporation must in effect distribute its earnings *"accumulated" during the entire taxable period* first and before it may distribute its accumulations as they were on March 1, 1913.

The Commissioner cites *Blair* v. *United States*, 63 Court of Claims 193. This case arose under the Revenue Act of 1918. The decision apparently was based, at least in part, upon subdivision (e) of Section 201 of the Act of 1918, which seems to have no application. This provision formed also a part of the 1921 Act (paragraph (f) of Section 201) which itself provided that it should "not be in effect after December 31, 1921."

The Board of Tax Appeals in *J. L. Washburn* v. *Commissioner,* 16 B. T. A. 1091, at 1098, had previously held the Blair case unsound and had declined to follow it. The Board in that decision understood the Blair case to be one where there was a capital deficit on March 1, 1913. The Commissioner claimed in that case that there was a surplus on March 1, 1913, of $106,460.51. He got this figure by considering the surrender of bonds and coupons of the par amount of $546,460.51 as a replacement of $440,000 of prior operating losses, and a contribution to surplus of the difference of $106,460.51. The court in its finding of fact 10, shows a net loss of $21,194.40 from March 1, 1913, to December 31, 1918. The question is stated in the opinion to be:

> "Where a corporation has a loss in excess of its gains *for the period of its corporate existence,* as well as for the period from March 1, 1913, to December 31, 1918, is a distribution of corporate funds to the stockholders in 1918 a taxable dividend within the meaning of the revenue act of 1918, or is such distribution a return of capital and therefore not taxable?" (Italics ours.)

As there was a net loss for the period after March 1, 1913, the condition of a loss *for the entire period of the corporate existence* could not be satisfied by a surplus of more than $21,194.40 on March 1, 1913. If the surrender of the bonds created a surplus, it would have been $106,460.51, instead of $21,194.40. If the surrender did not operate at all as creating a surplus, there was a capital deficit on March 1, 1913, of $440,000. If the surrender of the bonds be treated as having created a surplus as of March 1, 1913, such a surplus would clearly have been only a paid-in surplus and hence capital in its nature and on distribu-

tion non-taxable. Such a surplus would not change the facts as to an operating loss, if any, prior to March 1, 1913. It therefore would seem that the court treated the case as one where there was a capital deficit of $440,000 on March 1, 1913, a further (operating) deficit of $21,194.40 for the period March 1, 1913, to December 31, 1918, and an operating profit in the calendar year 1918 of $84,868.39, from which the dividend of $80,000 was paid in December, 1918. It said:

> "It was a distribution of its earnings and profits in 1918."

If there was a deficit in paid-in capital on March 1, 1913, the Blair case is obviously unsound, for no ordinary dividend could be paid by a corporation in that condition. The distribution would be from paid-in capital and hence would not be taxable income. If there was a surplus on March 1, 1913, arising out of the surrender of the bonds and coupons, still the decision, we submit, is wrong. In any event, it is of extremely doubtful value as an authority. The court does not mention the section of the 1918 Act corresponding to Section 201 (b) of the 1921 Act, on which the Commissioner relies here. *Edwards* v. *Douglas*, 209 U. S. 204, cited by it, depends on a statute totally different in language and purpose from the one before us. The opinion gives no reasons for the decision. It considers none of the arguments advanced here by either the Commissioner or the taxpayer. At best, the point of law decided is obscure.

III.

There Is Nothing to Show That the Administrative Practice of the Bureau of Internal Revenue Received the Implied Approval of Congress. The Bureau by Misinterpreting a Statute Cannot Bind the Courts to an Erroneous Conclusion Nor Can It Require Congress to Pass Legislation to Correct Its Errors.

The Commissioner makes the point that in this case he followed the established practice of the Bureau of Internal Revenue. On this point, we refer to pages 31 and 32 of the brief for Petitioner in the companion case of Thorsen (No. 212), October Term, 1933.

We submit that the judgment in this case was right and should be affirmed.

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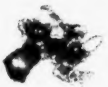
Of Counsel.



SUPREME COURT OF THE UNITED STATES.

Nos. 158 and 212.—October Term, 1933.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Charles J. Canfield. (158)	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.
William R. Thorsen, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. (212)	On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[January 15, 1934.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

These cases present the question of the construction of the following provisions of Section 201 of the Revenue Act of 1921, 42 Stat. 228:

"Sec. 201. (a) That the term 'dividend' when used in this title . . . means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913 . . .

"(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. . . ."

The respondent in No. 158 and the petitioner in No. 212 are stockholders of the West Side Lumber Company, a California corporation. The question is as to the amount properly taxable against them as their respective shares of a dividend of $5,100,000 paid by that company on April 14, 1923.

The findings of fact state that in addition to its original capital of $1,500,000, the company had a surplus on March 1, 1913, of

$4,332,684.78. Its profits and losses in the following years—ending on February 28 in each year—were as follows: 1914, a profit of $4,594.62; 1915, a loss of $193,139.67; 1916, a loss of $211,797.32; 1917 to 1923, inclusive, and from February 28, 1923 to April 14, 1923, profits aggregating $2,450,688.30. Prior to the dividend here involved, and for the years 1918 to 1923, the company had paid dividends amounting to $1,290,000.

The question is as to the proper treatment of the losses of 1915 and 1916. If these losses, over the profits of 1914, are not treated as reducing the surplus of March 1, 1913, but are charged against the subsequent profits, the entire amount of that surplus, or $4,332,684.78 was distributable exempt from the tax after the profits subsequent to February 28, 1913, had been distributed. On this basis, for which the taxpayers contend, the profits accumulated after February 28, 1913, would be deemed to amount to $2,050,435.93, leaving subject to the tax, after deducting prior dividends, the sum of $760,435.93.

If the losses of 1915 and 1916, over the profits of 1914, are treated as reducing the surplus of March 1, 1913, there remained of that surplus, on February 28, 1916, the sum of $3,932,432.41, which was distributable exempt from the tax after the subsequent profits and been distributed. With this application of the losses of 1915 and 1916, the subsequent profits subject to tax, after deducting prior dividends, amounted to $1,160,688.30.

The Board of Tax Appeals adopted the latter view and directed the determination of deficiencies accordingly. 24 B. T. A. 480. That decision was overruled by the Circuit Court of Appeals for the Seventh Circuit as to the respondent Canfield in No. 158 (62 F. (2d) 751), and was sustained by the Circuit Court of Appeals for the Ninth Circuit as to the petitioner Thorsen in No. 212 (65 F. (2d) 234). The cases come here on certiorari.

In deciding between these conflicting views, the outstanding, and we think the controlling, fact is that on February 28, 1916, the surplus of March 1, 1913, had actually been diminished by losses. The company continued in business after March 1, 1913, and exposed its accumulated profits to the hazard of that business. On February 28, 1914, the company still had those profits and an additional profit of $4594.62. But in the next two years the company lost $404,846.99, so that the surplus of March 1, 1913, was invaded. It is inaccurate to say that this was merely a matter of

bookkeeping. Under the findings of fact the losses must be deemed to have been actual losses, not mere bookkeeping entries. Hence, the decrease of the preexisting surplus was actual—as real as the preexisting surplus itself, as real as the subsequent profits. The surplus of March 1, 1913, was the amount of net assets over liabilities including capital stock.[1] When the losses of 1915 and 1916 were suffered, the net assets of March 1, 1913, shrunk accordingly. In the presence of that inescapable fact, the question is not whether the company could distribute, as being surplus of March 1, 1913, what no longer remained of that surplus—a manifest impossibility—but whether the statute entitled the company to treat subsequent profits as restoring what had been lost of the surplus of March 1, 1913, so that, to the extent of that replacement, the subsequent profits could be distributed to stockholders free of tax. That the question is one of such a replacement would be strikingly evident if the whole of the surplus of March 1, 1913, had been lost and an attempt had been made to treat later profits as restoring it. The fact that only a part of the surplus was lost does not alter the question as related to that part.

The argument that the surplus of March 1, 1913, constituted capital is unavailing. We are not here concerned with capital in the sense of fixed or paid-in capital, which is not to be impaired, or with the restoration of such capital where there has been impairment.[2] No case of impairment of capital is presented. We are dealing with a distribution of accumulated profits. Nor is it important that the accumulated profits as they stood on March 1, 1913, constituted capital of the company as distinguished from the gains or income which the company subsequently realized.[3] When a corporation continued in business after March 1, 1913, the dividends it later declared and paid to its stockholders, whether out of current earnings or from profits accumulated prior to that date, constituted income to the stockholders, and not capital, and were taxable as income if the Congress saw fit to impose the tax. *Lynch* v. *Hornby*, 247 U. S. 339. The provision of the Act of Con-

[1]Edwards *v.* Douglas, 269 U. S. 204, 214; Willcuts *v.* Milton Dairy Co., 275 U. S. 215, 218.

[2]Compare Hadden *v.* Commissioner, 49 F. (2d) 709.

[3]Southern Pacific Company *v.* Lowe, 247 U. S. 330; Gulf Oil Corporation *v.* Lewellyn, 248 U. S. 71; Lucas *v.* Alexander, 279 U. S. 573; Old Colony Railroad Co. *v.* Commissioner, 284 U. S. 552.

gress under consideration was a "concession to the equity of stockholders" with respect to receipts as to which they had no constitutional immunity. There is no question here of the receipt of "capital".

The fundamental contention of the taxpayers is that the statute created two distinct periods for tax purposes; that the accumulations for each period constituted "a fixed and static amount, not to be changed by happenings after the end of the period". That the statute does relate to two periods, the dividing line being March 1, 1913, and that the periods are distinct, is obvious. But it does not follow because there are two distinct periods that the accumulations for each period constitute "a fixed and static amount" and are to remain unaffected despite the vicissitudes of business. To attribute to the accumulated profits or surplus of March 1, 1913, embarked in a continued business, such a static condition is to ignore the course of business and to impute to the Congress an intention to consider, for tax purposes, the existence of that surplus as still continued notwithstanding its actual diminution or exhaustion. Such an intention to disregard realities so as to afford immunity from a tax is not lightly to be ascribed to the taxing authority. The "equity of stockholders", which we said in *Lynch* v. *Hornby, supra,* the Congress probably had in view, might reasonably require freedom from taxation on receiving a distribution of the accumulated profits of March 1, 1913, where those profits remained intact, but that equity is not apparent when those profits had been lost in whole or in part and immunity is sought from the taxation of an equivalent amount of profits subsequently earned.

Paragraphs (a) and (b) of section 201 disclose a single purpose and are to be construed in harmony with each other. They show that the Congress was careful to arrange its plan so that the right to receive, free of tax, a distribution of surplus accumulated prior to March 1, 1913, should not be exercised in such a fashion as to permit profits accumulated after that date to escape taxation. To that end the Congress provided that "every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913". Then follows the exemption which is strictly limited to a distribution of profits accumulated prior to March 1, 1913. Nothing is said as to a restoration of

those profits out of subsequent earnings if the former have been lost.

The argument for the stockholders stresses the word "accumulated". We think that the expression is made to carry too heavy a burden. The argument is substantially the same as that which is based on what seems to us to be an artificial conception of the two periods. What had been "accumulated" prior to March 1, 1913, was obviously not immune from the risk of loss. It is urged that the same rule should be applied whether the losses in the subsequent years preceded or succeeded the making of profits. But the actual course of events is not to be ignored. If there had been profits immediately after March 1, 1913, sufficient in amount to absorb later losses incurred before the time of distribution, it is manifest that the profits accumulated prior to March 1, 1913, would have remained intact. The case is different where, in the absence of such profits, losses necessarily diminish the prior accumulations. Thus, in the instant case there were no profits accumulated after March 1, 1913, and prior to February 28, 1916, except the small amount in 1914 which was wiped out by the losses of the two succeeding years. The profits from February 28, 1916, to February 28, 1919, amounted to $327,134.45. If there had been a distribution of these profits on February 28, 1919, it could not have been maintained that they constituted part of the surplus existing on March 1, 1913, or that they should escape taxation on the theory that they made good prior losses which had actually reduced that surplus. And the same is true of the profits subsequently made. Administrative practice appears to have been in accord with this view. See A. R. M. 82, 3 Cumulative Bulletin 36 (1920).

Our conclusion is that the judgment of the Circuit Court of Appeals for the Seventh Circuit in No. 158 should be reversed and that of the Circuit Court of Appeals for the Ninth Circuit in No. 212 should be affirmed.

It is so ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.